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How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law

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The European framework for creditor protection has undergone a remarkable transformation in recent years. While the European Court of Justice's Centros *case and its progeny have given European Union businesses free choice with respect to the state of incorporation, and hence to the substantive corporate law regime, the European Insolvency Regulation has introduced uniform conflict-of-law rules for insolvencies. However, this regime has opened up some forum shopping opportunities for corporate debtors. Both regulatory competition in corporate law and forum shopping in bankruptcy law have been discussed in the United States for years, while they are relatively new territory in the European Union.*

This article attempts to pull together the two emerging discussions and analyzes possible consequences for the relationship between shareholders, managers, and creditors in European corporations. We argue that in the absence of evidence of either a race to the top or the bottom, we cannot rule out adverse consequences of either regulatory competition in corporate law or forum shopping in bankruptcy. However, the discussion so far has largely considered only the

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consequences of the first type of regulatory arbitrage while neglecting the second. Hence, the issue of the "insolvencification" of corporate law rules has been brought up in order to enable national policymakers to impose their respective ideas about creditor protection on firms. We suggest that such attempts may be futile.

First, relabeling is possible only to a rather limited degree, and second, while restricting the scope for corporate law arbitrage, relabeling increases the incentives for forum shopping in bankruptcy. Ultimately, relabeling may even backfire, leading to a higher degree of bankruptcy forum shopping to avoid the very rules that have been insolvencified.

I. INTRODUCTION

The debate about regulatory competition and interaction between different legislative and regulatory levels has a long pedigree in U.S. corporate law scholarship. Scholars have argued for more than thirty years that states vying for incorporations have caused corporate law to race to the top,[1] to the bottom,[2] or to nowhere in particular.[3] Since the early 1990s, following empirical evidence of forum shopping by large corporate debtors, a related debate has developed with respect to

1. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 212-27 (1991); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 290 (1977); Ralph K. Winter, *The "Race for the Top" Revisited: A Comment on Eisenberg*, 89 COLUM. L. REV. 1526, 1528 (1989). *See generally* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 14-31 (1993).

2. *See* Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race To Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168, 1171-82 (1999); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1483-84 (1992); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 705 (1974).

3. *See* William W. Bratton, *Corporate Law's Race to Nowhere in Particular*, 44 U. TORONTO L.J. 401, 401 (1994). For revisionist views denying the relevance of interstate competition, see Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 684-85 (2002); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 591-93 (2003) [hereinafter Roe, *Delaware's Competition*]; and Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2495-96 (2005) [hereinafter Roe, *Delaware's Politics*].

bankruptcy law.[4] Some scholars suggest that forum shopping between different federal bankruptcy courts has allowed corporate debtors to ensure that bankruptcy proceedings are conducted in the most efficient way possible.[5] The opposing camp argues that forum shopping is essentially destroying the bankruptcy system to the detriment of creditors and to the benefit of the managers who have led firms into bankruptcy.[6]

Good old Europe, as so often, is different. Little was heard about regulatory competition in either field from the other side of the Atlantic Ocean until recently, because the regulatory environment in the European Union (EU) simply did not allow any. However, this has changed drastically during the last few years. In March of 1999, the European Court of Justice's (ECJ) *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen* decision paved the way for corporate law arbitrage within the EU by granting European businesses the right to incorporate in any EU Member State (State or Member State), no matter where their business is run.[7] Correspondingly, the ruling prevents Member States from imposing their own corporate law on such businesses, other than under very limited conditions.[8] In the last few years, newly incorporated businesses have started to take advantage of this new development, choosing English law in relatively high numbers.[9]

4. *See, e.g.*, Lynn M. LoPucki & William C. Whitford, *Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 1991 WIS. L. REV. 11, 12.

5. *See* Marcus Cole, *"Delaware Is Not a State": Are We Witnessing Jurisdictional Competition in Bankruptcy?*, 55 VAND. L. REV. 1845, 1859-76 (2002); Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 NW. U. L. REV. 1357, 1358-59 (2000); David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 DEL. L. REV. 1, 28-29 (1998) [hereinafter Skeel, *Bankruptcy Judges and Bankruptcy Venue*]; David A. Skeel, Jr., *What's So Bad About Delaware?*, 54 VAND. L. REV. 309, 328 (2001) [hereinafter Skeel, *What's So Bad About Delaware?*]; Kenneth M. Ayotte & David A. Skeel, Jr., *Why Do Distressed Companies Choose Delaware? An Empirical Analysis of Venue Choice in Bankruptcy* 15 (Univ. Pa. Inst. for Law & Econ., Research Paper No. 03-29, 2004), *available at* http://ssrn.com/abstract=463001.

6. *See* LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS (2005); Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom,"* 54 VAND. L. REV. 231, 270 (2001).

7. *See* Case C-212/97, 1999 E.C.R. I-1459, I-1497 to 98; *see also infra* text accompanying notes 58-61.

8. *See Centros*, 1999 E.C.R. at I-1497 to 98.

9. *See* John Armour, *Who Should Make Corporate Law? EC Legislation* versus *Regulatory Competition*, 58 CURRENT LEGAL PROBS. 369, 386 (2005) (providing data on so-

Independent of this new development, the European Community (EC) adopted an important piece of legislation on bankruptcy law a year after *Centros*: EC Council Regulation 1346/2000 on insolvency proceedings (EIR).[10] The EIR identifies the Member State that has jurisdiction to open main proceedings having a universal effect (at least within the EU and with some important exceptions) as the place where the debtor has its "centre of main interests" (COMI).[11] Most importantly, it identifies the law applicable to insolvency proceedings as the law of the State of the court opening the proceedings.[12] However, the fuzziness of the COMI standard has allowed some forum shopping, which can be observed in emerging case law on the EIR.[13]

In short, both *Centros* and the EIR have increased the scope of private parties' free choice in determining the law applicable to companies and their insolvency. By allowing corporate law arbitrage and bankruptcy forum shopping, Europe has become similar to the United States. Yet, there is still one crucial difference. While creditors are a concern of corporate law only to a very limited degree in the United States, EU Member States have traditionally tried to protect corporate creditors through corporate law.[14] And while the U.S. debate on regulatory competition is almost exclusively focused on the relationship between shareholders and managers, the relationship with creditors cannot be ignored in its European analogue. At the same time, because both corporate law and bankruptcy law are concerned with creditors, the two levels of regulatory arbitrage need to be dealt with as two sides of the same coin.

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called "GmbH limited," i.e., German businesses incorporated as English private-limited companies); Alexander Schall, *The UK Limited Company Abroad—How Foreign Creditors Are Protected After* Inspire Art *(Including a Comparison of UK and German Creditor Protection Rules)*, 2005 EUR. BUS. L. REV. 1534, 1535 (reporting estimates that there are more than 20,000 U.K. limited companies (Ltds) with their real seat in Germany); *see also* Marco Becht et al., *Where Do Firms Incorporate?* (European Corp. Governance Inst., Law Working Paper No. 70/2006, 2006), *available at* http://ssrn.com/abstract=906066 (providing evidence on other Member States businesses' incorporations in the United Kingdom).

10. Council Regulation 1346/2000, 2000 O.J. (L 160) 1 [hereinafter EIR].

11. *Id.* art. 3.

12. *Id.* art. 4.

13. Horst Eidenmüller, *Free Choice in International Company Insolvency Law in Europe*, 6 EUR. BUS. ORG. L. REV. 423, 428 (2005).

14. *See* Katharina Pistor et al., *Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries*, WORLD BANK RES. OBSERVER, Spring 2003, at 89, 108. *See generally* Luca Enriques & Jonathan R. Macey, *Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules*, 86 CORNELL L. REV. 1165 (2001).

Our Article attempts to pull the two issues together and to analyze how they shape the relationship between corporate debtors and their creditors. In order to do so, in Part II we first sketch out how different jurisdictions may interact with each other in regulating the relationship between companies and their creditors, first in general and then within the EC framework. The emphasis will be on the varying degree of deference to private parties' choices that derives from States' private international law rules and on its implications for regulatory competition.

We will next show, in Part III, that past efforts at positive harmonization of corporate law by the EC have failed to make EU corporate laws equivalent in terms of creditor protection, so some jurisdictions may be more attractive than others to those who make the (re)incorporation choice. We argue that while some companies may reincorporate in order to exploit some categories of creditors, a race to the bottom is unlikely to develop within the EU and there is currently no conclusive evidence of a race to the bottom or to the top.

We then turn in Part IV to the EIR and its implications for the relationship between EU companies and their creditors. After briefly describing its main provisions, we turn to regulatory arbitrage with respect to insolvency law. We will show that the EIR leaves some possibility for arbitrage, because a switch of COMI by a corporate debtor on the brink of insolvency is not effectively prevented. However, we will also show that because it is most often creditors who file for bankruptcy in the EU, regulatory arbitrage is a weapon in their hands too. Subsequently, we argue that it is unrealistic to expect any EU Member State to supply debtor-friendly insolvency law rules in order to prosper as a bankruptcy venue.

In order to pull the two issues together, in Part V we finally discuss "relabeling": the idea that by qualifying a corporate law provision as an insolvency law one, it may apply to insolvent companies with a COMI in the relevant jurisdiction no matter where the company is incorporated. We highlight an important implication of relabeling that has been overlooked in the literature so far, which is the fact that it may increase the regulatory surplus to be gained from insolvency forum shopping. We suggest that relabeling may not necessarily be desirable if arbitrage gains are shifted from corporate law to insolvency law. Part VI concludes.

II. REGULATORY INTERACTIONS AMONG JURISDICTIONS

All jurisdictions impose mandatory rules aimed at protecting creditors vis-à-vis their (corporate) debtors. In a multijurisdictional setting, however, it may be possible for private parties to avoid such rules by choosing a different jurisdiction not imposing them whenever it is in their interest. The choice will be made either jointly by debtors and their voluntary creditors or unilaterally by the debtors with the creditors giving tacit consent by agreeing to enter into a relationship with the debtors or by not reserving *ex ante* the right to veto such a choice. Of course, involuntary creditors and, more generally, nonadjusting creditors can never be said to give consent to this kind of choice.[15] Because they have a credit relationship with the corporate debtor whom they have entered into an agreement with unwillingly or whose terms they are unable or unwilling to renegotiate (in order to react to unilateral moves by the debtor), they can only bear the venue choice's consequences.[16]

This Part evaluates in general terms the degree to which States may defer to free choice of law in the realm of the creditor/corporate debtor relationship and the various means through which they can limit such a choice. We also briefly outline the implications of multiple jurisdictions' options with regard to private parties' choice. Our focus in this Part will be mainly on corporate law, but the analysis can be easily extended to securities regulation and insolvency law.[17] For analytical purposes, we will look first at possible interactions among States in the absence of supranational institutions restraining jurisdictions' options with regard to substantive regulation and/or conflicts of law.[18] Then we will introduce one such institution, the EC, into the framework.[19]

15. Nonadjusting creditors are those that do not "adjust" the terms of their claims to anticipate or take into account the effects of new developments. *See* Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 864 (1996).

16. *See id.*

17. Needless to say, while tort law is sometimes used as a means to protect creditors (even voluntary ones) against (corporate) debtors' opportunism, tort law is of no concern here because it makes little sense to talk about free choice with regard to it.

18. *See infra* Part II.A.

19. *See infra* Part II.B.

A. *Regulatory Interactions in the Absence of Cooperation*

Jurisdictions' attitudes toward choice of law range from absolute negation of free choice to absolute respect for it.[20] In the former case, rules are imposed on companies (or transactions) having a meaningful connection to the relevant jurisdiction, no matter what private parties' choice of law is. In the latter case, there are no restrictions on free choice of law, but for the fact that normally one can opt-out of a single mandatory rule only by choosing another jurisdiction for a whole class of transactions and conducts.[21] For example, one can opt out of the German rule on minimum capital for limited liability companies (*Gesellschaften mit beschränkter Haftung* (GmbHs)) only by choosing a different jurisdiction to regulate the firm as a corporation.[22]

1. Choice-Denying Techniques

A jurisdiction can effectively deprive private parties of free choice of corporate law by providing that its own corporate law applies if a corporation has a sufficiently strong connection with it. Most commonly, what counts is where the "real seat" (whatever this means) is located.[23] Whenever a corporation's real seat is within a jurisdiction's borders, any incorporators' choice of a foreign law is disregarded, leading to the nonrecognition of the foreign entity.[24]

The real-seat doctrine can be symmetric or asymmetric. In the former case, a jurisdiction does not accept a foreign firm's choice of that jurisdiction's corporate law unless the firm establishes its real seat within the territory (this is the case, for example, in Germany).[25] In other words, the symmetric real-seat doctrine implies a self-imposed

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20. *See infra* notes 23-42 and accompanying text.

21. *See* Benjamin Angelette, Note, *The Revolution that Never Came and the Revolution Coming*-De Lasteyrie du Salliant, Marks & Spencer, Sevic Systems *and the Changing Corporate Law in Europe*, 92 VA. L. REV. 1189, 1200-01 (2006).

22. *See id.*

23. Werner F. Ebke, *The "Real Seat" Doctrine in the Conflict of Corporate Laws*, 36 INT'L LAW. 1015, 1034-36 (2002).

24. *See id. But see* Case C-208/00, Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC), 2002 E.C.R. I-9919; *see also, e.g.*, Bundesgerichtshof [BGH] [Federal Court of Justice] Mar. 21, 1986, 97 Entscheidungen des Bundesgerichtshofes in Zivilsachen [BGHZ] 269 (F.R.G.); Bernhard Großfeld, *Internationales Gesellschaftsrecht*, *in* JULIUS VON STAUDINGER, KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH MIT EINFÜHRUNGSGESETZ UND NEBENGESETZEN cmt. 26 (13th ed. 1998).

25. *See* Ebke, *supra* note 23, at 1034-35.

export ban on a jurisdiction's corporate law.[26] In the latter case, no such export ban is self-imposed and a foreign firm is free to choose the relevant jurisdiction's corporate law, no matter where their real seat is located (as is the case in Italy).[27]

When the real-seat doctrine governs, the only way to escape the reach of mandatory rules will be to locate (or relocate) the corporation's real seat in another jurisdiction, which can of course be costly.[28] How costly will, of course, depend on how "real" the real seat must be and on how international the company's operation is.[29] Moving one's headquarters implies that at least the human capital needed to direct the firm be moved, while the (re)location will imply that some other laws and regulations from the relocation State will apply to the firm's headquarters, such as labor and income tax laws.[30]

2. Choice-Restricting Techniques

The asymmetric real-seat doctrine can hardly be distinguished from a pseudo-foreign corporation statute that declares domestic corporate law overall applicable to domestic businesses (however defined) incorporating as foreign companies.[31] Often, however, pseudo-foreign corporation statutes overimpose a subset of domestic rules not comprising the entire corporate law body, the rest deferring to the law of the state of incorporation.[32] Of course, the more

26. *See id.* at 1036; *see also* Eva Micheler, *§ 254*, *in* 2 KOMMENTAR ZUM AKTIENGESETZ cmt. 38 (Peter Doralt et al. eds., 2003) (reporting that in Austria the prevailing opinion is a shareholder resolution to relocate to another country results in the dissolution of the corporation).

27. *See* Law No. 218 of may 31, 1995 art. 25, Gazzetta Ufficiale della Repubblica Italiana [Gazz. Uff.] [Official Gazette of Italy], june 3, 1995, No. 128 (Italy).

28. *See* Becht, Mayer & Wagner, *supra* note 9, at 6 & n.10.

29. For instance, in Germany the headquarters only have to be located within its territory; in Italy, Italian corporate law also applies if the principal place of business is in Italy, thus making companies operating mainly in Italy more captive to Italian corporate law than German ones to German law. *See* Law No. 218 of may 31, 1995 art. 25 (Italy); Seth Chertok, *Jurisdictional Competition in the European Community*, 27 U. PA. J. INT'L ECON. L. 465, 482-84 (2006).

30. *See* Becht et al., *supra* note 9, at 6 & n.10.

31. *See* Hanne Søndergaard Birkmose, *A Market for Company Incorporations in the European Union?—Is* Überseering *the Beginning of the End?*, 13 TUL. J. INT'L & COMP. L. 55, 93-94 (2005).

32. *Id.* at 95. Such was the case with Dutch law on pseudo-foreign corporations the ECJ struck down in its *Inspire Art* judgment. Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., 2003 E.C.R. I-10,155 (striking down Wet op de Formeel Buitenlandse Vennootschappen [Law on Formally Foreign Companies] of Dec.

encompassing the subset of domestic rules, the more limited the private parties' free choice.

A private party's free choice can also be restricted by making national rules applicable to foreign entities, no matter where their real seat is located.[33] Although this is uncommon in the corporate law area, it is normally what happens, with due qualifications, in securities regulation and insolvency law. National securities regulation traditionally applies to foreign issuers as long as they offer their securities, or their securities are widely traded, in the relevant jurisdiction.[34] In a strictly territorialist setting, national insolvency law usually applies to firms having assets in the relevant jurisdiction, no matter what their nationality is or where their real seat is located, but only to assets within the jurisdiction.[35]

Finally, jurisdictions always reserve the general power to refuse the application of foreign (corporate) law under the public policy exception, which leaves judges the option to apply domestic law if the outcome deriving from application of the relevant foreign law would contrast with fundamental principles and values.[36]

3. Deference to Free Choice

Jurisdictions may also decide to put no limits on private parties' free choice. In the corporate law domain, this is the case whenever the choice-of-law rules follow the incorporation doctrine and none of the choice-restricting techniques outlined above are deployed.[37] The only element of inflexibility derives from the fact that, as already hinted, by incorporating in a given State, companies subject themselves to the State's whole set of corporate law rules.[38] In other words, a company

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17, 1997, Staatsblad van het Koninkrijk der Nederlanden [Stb.] [Official Gazette of the Kingdom of the Netherlands], Apr. 28, 2005, No. 230).

33. Such is traditionally the case with securities regulation. *See infra* text accompanying note 34.

34. *See* Harald Baum, *Globalizing Capital Markets and Possible Regulatory Responses*, *in* LEGAL ASPECTS OF GLOBALIZATION: CONFLICT OF LAWS, INTERNET, CAPITAL MARKETS AND INSOLVENCY IN A GLOBAL ECONOMY 77, 90-93 (Jürgen Basedow & Toshiyuki Kono eds., 2000).

35. *See* Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 MICH. L. REV. 2177, 2179 (2000).

36. *See, e.g.*, Case C-208/00, Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC), 2002 E.C.R. I-9919.

37. *See supra* Part II.A.2.

38. *See* Mathias M. Siems, *The Rules on Conflict of Laws in the European Takeover Directive*, 1 EUR. COMPANY & FIN. L. REV. 458, 475 (2004) ("The concept of regulatory competition means that you can opt into the rules of one particular legal system, but not that

may not engage in "cherry picking," choosing State *A*'s corporate law rules on, e.g., minimum net assets and State *B*'s corporate law rules on, e.g., directors' liability.

This is less the case, however, with regard to relationships with creditors in two ways. First, because traditionally these rules are in part corporate law and in part insolvency law, as long as conflict-of-law rules differ with regard to the two bodies of law, it might be possible to select one State's corporate law and another State's insolvency law.[39] Second, a corporation and one of its creditors or classes of creditors might agree that they would be better off if the applicable corporate law were a different one than that otherwise applying to the corporation. They could create a corporate vehicle in the State of their choice and make it the corporate debtor in their relationship. By doing so, they would choose their favorite corporate law without any need to change the corporate law regulating relationships among shareholders, between shareholders and managers, and between shareholders and other creditors. Of course, they will do so only if the advantages of the corporate law of choice more than offset the disadvantages deriving from the fact that only the vehicle will be liable for the corporate debt.[40] This may happen only when a viable business is assigned to the corporate vehicle, as the case may be in a conglomerate.

Jurisdictions can defer to free choice to varying degrees, even leaving aside the possibility for the use of the choice-restricting techniques described in Part II.A.2. First, a jurisdiction may opt for geographically-restricted free choice, i.e., limited to one or more other jurisdictions.[41] Normally, this will be the outcome of some form of cooperation among States, like a treaty for the reciprocal recognition of companies.[42] Second, free choice can be granted either at the incorporation stage only or midstream as well thereby allowing

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you can freely combine the law of different countries . . . ."); Nicole Rothe, Comment, *Freedom of Establishment of Legal Persons Within the European Union: An Analysis of the European Court of Justice Decision in the* Überseering *Case*, 53 AM. U. L. REV. 1103, 1110 (2004).

39. *See infra* Part IV.

40. Unless the parent guarantees that debt, in which case of course the corporate law of the parent would come back to the foreground.

41. This is the effective result of the ECJ case law, which allows free choice within the European Economic Area (EEA). *See infra* Part II.B.

42. *See generally* Patrick B. Griffin, *The Delaware Effect: Keeping the Tiger in Its Cage. The European Experience of Mutual Recognition in Financial Services*, 7 COLUM. J. EUR. L. 337 (2001).

companies to choose a State's law at a later time. In the former case, incorporators are free to choose any given jurisdiction's corporate law. If, however, they choose the domestic one, they cannot change their mind later. If they choose another jurisdiction, they cannot reincorporate as a domestic corporation later. In the latter case, a choice made at the outset can be modified later. It is also possible that restrictions could be placed on outbound, or, less likely, inbound, midstream reincorporations, such as laws granting existing creditors the right to veto reincorporations.

4. Implications for Interjurisdictional Interaction

Let us now briefly comment on whether and to what extent States are affected by each other's choices in regulating the relationships between creditors and corporate debtors.

If all the relevant jurisdictions adopt the real-seat doctrine, States would face very low constraints on their freedom to design mandatory corporate law rules due to the potentially high costs of reincorporating abroad. Their only concerns could be that domestic businesses might suffer a competitive disadvantage, e.g., a higher cost of debt financing, vis-à-vis businesses from other States or, similarly, that the State would be at a disadvantage in attracting foreign investment. At best, the fact that other jurisdictions better regulate companies can only prompt changes when it is felt that those rules translate into a regulatory environment more conducive to corporate investment or more generally into a more effective and business-friendly set of rules.[43] When this happens, it means that policymakers are genuinely concerned about preserving or enhancing their country's ability to attract investment.[44] They care about "yardstick competition,"[45] leading to "regulatory emulation" among the States in some cases.[46]

43. *See* Ehud Kamar, *Beyond Competition for Incorporations*, 94 GEO. L.J. 1725, 1731-43 (2006) (describing the various methods European countries have used to attract investment).

44. *See id.*

45. *See* Pierre Salmon, *Political Yardstick Competition and Corporate Governance in the European Union*, *in* INVESTOR PROTECTION IN EUROPE: CORPORATE LAW MAKING, THE MIFID AND BEYOND 31, 41-44 (Guido Ferrarini & Eddy Wymeersch eds., 2006).

46. *See* Stephen Woolcock, *Competition Among Rules in the Single European Market*, *in* INTERNATIONAL REGULATORY COMPETITION AND COORDINATION: PERSPECTIVES ON ECONOMIC REGULATION IN EUROPE AND THE UNITED STATES 289, 298 (William Bratton et al. eds., 1996).

To the extent that at least one jurisdiction allows for free choice, and at least one other jurisdiction adopts the asymmetric real-seat doctrine, a market for rules exists. Only States adopting the symmetric real-seat doctrine are totally out of such a market. Those States adopting the asymmetric real-seat doctrine enter the market, but only as suppliers of corporate law rules, impeding access to their own "consumers." Jurisdictions adopting choice-restricting techniques, in turn, not only enter the market as suppliers of corporate law rules, but also allow their consumers to choose. Nevertheless, their consumers' choice is constrained, because freedom of choice cannot be used to escape those rules that also apply to (pseudo-)foreign corporations.

The higher the number of jurisdictions that allow choice, the deeper and potentially more dynamic the market. More precisely, the degree of dynamism and competition in a market for rules depends on a number of factors. Examples include: how easy it is to exercise free choice; how relevant the differences among existing jurisdictions are, i.e., how big the regulatory surplus that can be obtained by moving is; whether any jurisdiction and its policymakers are willing and able to attract foreign incorporations; and so on.

When free choice is a real option in practice and no jurisdiction cares about attracting foreign corporations, some form of weak, "defensive" regulatory competition can develop, in which States adapt their laws to the more attractive features of other jurisdictions in order to retain existing, and lure prospective, domestic companies. In the absence of a clear maximand, such as franchise tax revenue in Delaware,[47] States will take into account the interests of all stakeholders that have some influence on the political process. Hence, any effects regulatory competition may have on the development of the law will be mitigated. Although shareholders, as the group deciding where to incorporate, have a structural advantage over creditors in regulatory competition, legislation beneficial to the former and detrimental to (nonadjusting) creditors need not necessarily ensue if creditors have sufficient political representation or can gain the support of well-organized interest groups, such as trade unions and trade associations.

If one jurisdiction actively engages in attracting (re)incorporations from abroad, a situation very similar to the current situation in the

47. *See* Michal Barzuza, *Price Considerations in the Market for Corporate Law*, 26 CARDOZO L. REV. 127, 157-59 (2004); Cary, *supra* note 2, at 668-69.

United States, as described by Robert Daines, exists: each of the market participants competes with the active jurisdiction (Delaware in the United States) for (re)incorporations of its domestic companies.[48] In other words, there is not one single market for incorporations, but rather *n* minus one markets, if *n* is the number of jurisdictions leaving free choice to their businesses and where there are two suppliers for each market: "Delaware" and the home state.[49]

Of course, such a multiple-market setting can be very competitive as long as "Delaware" remains active in attracting (re)incorporations. In fact, "Delaware" will not only itself innovate, but it will also respond to any attractive market innovation by one of its competitors; this response, in turn, will prompt a response from each of the other competitors.[50] In such a case, regulatory competition may entail interjurisdictional "externalities," whereby rules have an effect on constituencies located outside the state, while only groups located within the state are taken into account in the political process.[51] This may have detrimental effects on creditors if they are disproportionately located outside the state of incorporation.

As already seen, defensive regulatory competition in the absence of a "Delaware" can raise no worry about such externalities. States typically have to take the interests of both shareholders and creditors into account and, therefore, "internalize" the effects of any corporate law reform through the political process. Even before that, the interests of relevant stakeholders would be taken into account no less than in any "isolated" corporate law reform effort.[52] However, in the presence of a "Delaware," jurisdictions may have to sacrifice these interests if they want to retain their corporations by enacting legislation benefiting shareholders and managers, but possibly harming nonadjusting creditors.

Finally, one can imagine a scenario in which various jurisdictions actively compete in order to attract incorporations. Such was the case

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48. *See* Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1575 (2002).

49. *See id.* at 1600.

50. *See generally* Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REG. 209 (2006).

51. *See* Jan Wouters, *European Company Law:* Quo Vadis*?*, 37 COMMON MKT. L. REV. 257, 289, 294-98 (2000).

52. *See* Luca Enriques, *EC Company Law and the Fears of a European Delaware*, 15 EUR. BUS. L. REV. 1259, 1274 (2004); Tobias H. Tröger, *Choice of Jurisdiction in European Corporate Law—Perspectives of European Corporate Governance*, 6 EUR. BUS. ORG. L. REV. 3, 62 (2005).

in the United States at the end of the nineteenth century and the beginning of the twentieth.[53] For various reasons that are not worth exploring here, the conditions under which this scenario developed in the United States at that time were quite unique, and, therefore, highly unlikely to be reproduced.[54] Intuitively, with multiple competitors acting in the same market, the regulatory environment is most conducive to innovation and rules that most cater to the interests of those who make the decision on where to incorporate.

B. Regulatory Interactions Among Jurisdictions in the Presence of Cooperation: The EU Case

In the previous Subpart we analyzed a scenario of multiple jurisdictions making uncoordinated, unilateral choices with regard to free choice of corporate law. In this Part, we concentrate upon EU Member States and briefly describe how the EC institutions can affect regulatory interactions among jurisdictions with regard to free choice and the substantive regulation of the relationships between creditors and corporate debtors.[55] The EC introduced a strong form of cooperation into the framework of otherwise unilateral choices with regard to regulatory interactions. We show that cooperation at the EC level can lead to a higher or lower degree of deference toward private parties' free choice (and hence contractual freedom and regulatory competition), depending on whether the EC institutions foster

53. *See* Luca Enriques, *The Comparative Anatomy of Corporate Law*, 52 AM. J. COMP. L. 1011, 1029-30 n.116 (2004) (reviewing REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (2004)).

54. *See id.*

55. Of course, the EC or an EC-like institution is just one possible form of international cooperation. Other forms include bilateral agreements. For instance, treaties exist requiring the recognition of American companies, e.g., between Germany and the United States, Treaty on Friendship, Commerce and Navigation, art. XXV, U.S.-F.R.G., Oct. 29, 1954, 7 U.S.T. 1839, and between Italy and the United States, Treaty on Friendship, Commerce and Navigation, art. II, U.S.-Italy, Feb. 2, 1948, 63 Stat. 2255. On the effects of these treaties, see BGH Jan. 29, 2003, 153 BGHZ 353 (F.R.G.) (recognizing a foreign corporation's capacity and standing to sue in Germany). *See also* Jens C. Dammann, *Amerikanische Gesellschaften mit Sitz in Deutschland*, 68 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT 607 (2004) (F.R.G.); Tito Ballarino, *La società per azioni nella disciplina internazionalprivatistica*, *in* 9* TRATTATO DELLE SOCIETÀ PER AZIONI 3, 93-94 (G.E. Colombo & G.B. Portale eds., 1994) (Italy). By contrast, the equivalent Austrian Treaty explicitly requires that limited liability companies maintain a central office within the territory of their incorporation. Treaty of Friendship, Commerce and Consular Rights, art. IX, U.S.-Austria, June 19, 1928, 47 Stat. 1876.

companies' mobility and mutual recognition rather than impose substantive mandatory rules on private parties.

1. Negative Harmonization

Negative harmonization on the basis of the Treaty Establishing the European Community (EC Treaty), which provides for freedom of establishment in article 43, as implemented by the ECJ's case law, imposes restraints on choice-denying techniques.[56] The *Centros-Überseering-Inspire Art* triad requires Member States to recognize foreign EU (and European Economic Area (EEA)) corporations' legal capacity[57] and allows restrictive measures only under very limited circumstances.[58] Any such measures "liable to hinder or make less attractive the exercise" of the freedom of establishment need to satisfy the criteria set out in *Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* (*Gebhard*).[59] That is, "they must be applied in a nondiscriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it."[60] While Member States may take measures to prevent or penalize fraud or abuse,[61] broad-sweeping statutes generally imposing national creditor-protection devices on pseudo-foreign corporations are thus impermissible. Because those imperative requirements are apparently

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56. Treaty Establishing the European Community, Nov. 10, 1997, 1997 O.J. (C 340) 3 [hereinafter EC Treaty]; *see* Francesco Munari & Paolo Terrile, *The* Centros *Case and the Rise of an EC Market for Corporate Law*, *in* CAPITAL MARKETS IN THE AGE OF THE EURO: CROSS-BORDER TRANSACTIONS, LISTED COMPANIES AND REGULATION 529, 540-46 (Guido Ferrarini, Klaus J. Hopt & Eddy Wymeersch eds., 2002). For a general overview of harmonization and regulatory competition under article 43, see EU LAW 457-67 (Josephine Steiner et al. eds., 9th ed. 2006).

57. *See, e.g.*, BGH Sept. 19, 2005, II ZR 372/03, 58 DER BETRIEB [DB] 2345 (2005) (F.R.G.) (recognizing a Liechtenstein corporation's legal capacity in Germany, irrespective of its real seat).

58. *See* Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459, I-1496 to 98; Case C-208/00, Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC), 2002 E.C.R. I-9919, paras. 1-2 (holding of the court); Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., 2003 E.C.R. I-10,155, paras. 1-2 (holding of the court).

59. Case C-55/94, 1995 E.C.R. I-4165, I-4197.

60. *Id.* at I-4197 to 98. As an example of the application of the *Gebhard* factors, see *Centros*, 1999 E.C.R. at I-1495; *Inspire Art*, 2003 E.C.R. para. 133.

61. *See Centros*, 1999 E.C.R. at I-1496; *Inspire Art*, 2003 E.C.R. para. 136.

narrowly construed, Member States are to a large degree forced to allow for free choice among EU corporate laws.

The actual extent of Member States' discretion is still unclear and possibly will remain so for a long time. What is worth highlighting here is that to the extent that private international law rules have not been harmonized, they are still an issue of national legislation. One could conclude from this that only the result of the conflict-of-law analysis in each particular case needs to be measured against the requirements of primary EC law.[62] However, in *Überseering BV v. Nordic Construction Co. Baumanagement GmbH*, the ECJ also held that a corporation validly incorporated in the Netherlands is entitled under articles 43 and 48 of the EU Treaty to exercise the freedom of establishment in Germany as a corporation incorporated in the Netherlands.[63] As a result, Member States will have to recognize not only the legal capacity of pseudo-foreign corporations, but also a certain substantive core of the corporate law of the state of incorporation, although it is not clear how far this core extends.[64] Outside of it, the application of the law of the state of incorporation is not imperative. Whether something is considered corporate or insolvency law is largely an issue of the national conception of these fields. Member States may even "relabel" rules as insolvency law if it serves the purpose of being able to apply their own law under the

62. *See* Erich Schanze & Andreas Jüttner, *Die Entscheidung für Pluralität: Kollisionsrecht und Gesellschaftsrecht nach der EuGH-Entscheidung "Inspire Art,"* 48 DIE AKTIENGESELLSCHAFT [AG] 661, 665 (2003) (F.R.G.) (pointing out that articles 43 and 47 of the Treaty on European Union do not intend to harmonize private international law); Peter Ulmer, *Gläubigerschutz bei Scheinauslandsgesellschaften*, 57 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 1201, 1205 (2004) (F.R.G.) (same).

63. Case C-208/00, 2002 E.C.R. para. 80.

64. The German *Bundesgerichtshof* recently held that it follows from the recognition of the legal personality of English companies that the liability of managers and shareholders to corporate creditors is determined by the law of incorporation. BGH Mar. 14, 2005, II ZR 5/03, 60 Betriebs-Berater [BB] 1016 (2005) (F.R.G.). *But see* Gebhard Rehm, *Völker- und europarechtliche Vorgaben für die Bestimmung des Gesellschaftsstatuts*, *in* AUSLÄNDISCHE KAPITALGESELLSCHAFTEN IM DEUTSCHEN RECHT § 2 cmt. 70, at 39 (Horst Eidenmüller ed., 2004) [hereinafter AUSLÄNDISCHE KAPITALGESELLSCHAFTEN] (explaining that it would be theoretically possible to recognize foreign corporations as such, but to apply certain German law provisions to them). Under the most radical position in German literature, this core shrinks to legal capacity, while German law still applies to all other issues, including the main creditor-protection doctrines. *See* Holger Altmeppen & Jan Wilhelm, *Gegen die Hysterie um die Niederlassungsfreiheit der Scheinauslandsgesellschaften*, 57 DB 1083 (2004); Holger Altmeppen, *Schutz vor "europäischen" Kapitalgesellschaften*, 57 NJW 97 (2004); *see also* Landgericht Kiel [LG Kiel] [Kiel Trial Court] Apr. 20, 2006, 10 S 44/05, 61 BB 1468 (2006) (qualifying the duty to file for insolvency as corporate law and allowing a damages claim against an English Ltd under German Law).

applicable conflict-of-law rules, as long as the *Gebhard* criteria are not violated.

We will briefly address the issue of conflicts of law again within the context of the most important creditor-protection mechanisms later in Part III.A and reflect upon "relabeling" strategies in Part V. For now, suffice it to say that *Centros* and its progeny have reshaped the EU corporate law landscape possibly more than many national reforms in the various Member States and certainly more than any EC positive harmonization effort thus far.

2. Positive Harmonization

With positive harmonization, the EC imposes on Member States an obligation to adopt certain rules (through directives) or directly imposes such rules on EU (and EEA) citizens and firms (through regulations).[65] Positive harmonization can be *substantive* whenever it defines the content of national corporate laws or it can be *procedural* and relate to *choice of law* itself either by promoting or by reducing it. Of course, individual harmonization measures may contain both substantive harmonization rules and choice-of-law-related ones; however, the distinction is useful in order to emphasize the kind of impact harmonization can have on free choice.

Substantive harmonization measures can preempt States' legislative powers to a varying degree.[66] Total preemption occurs in the case of maximum harmonization, while minimum harmonization leaves greater room for States' intervention in the harmonized area.[67]

When maximum harmonization measures are adopted, Member States must adopt the rules devised and may not impose stricter or additional rules.[68] Here, the degree of uniformity achieved is the highest, but the regulatory outcome, of course, is not necessarily the most restrictive. If the harmonizing measures leave some room for contractual freedom, the EC prevents Member States from further

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65. *See generally* PAUL CRAIG & GRÁINNE DE BÚRCA, EU LAW: TEXT, CASES, AND MATERIALS (3d ed. 2003).

66. *See, e.g.*, CATHERINE BARNARD, THE SUBSTANTIVE LAW OF THE EU: THE FOUR FREEDOMS 508-20 (2004).

67. *See id.* The same is also true in the case of optional harmonization. It can take many forms, such as a choice between two mandatory rules that may be given to the Member States or to private parties or to both, or the provision of default rules, or even the requirement that States introduce a regime that private parties will be free to choose through an opt-in decision. *See id.* at 515.

68. *See id.* at 508-20.

restricting it. At the same time, the harmonized regime may turn out to be excessively lenient; for example when the compromise-prone outcome of the EC legislative process sets an excessively low level of regulation and, for whatever reason, private parties are unable to bind themselves effectively to a stricter regime by contract or are prevented by the harmonizing measure itself to enter into such kind of agreement. In any event, regulatory competition is banned whether it would take, as is usually the case, the direction of a greater respect for contractual freedom or the opposite one.

With minimum harmonization measures, the EC requires Member States to impose at least the EC-devised rules, but Member States retain the power to impose additional or stricter rules (so-called "goldplating").[69] When minimum harmonization couples with mutual recognition, the stricter national rules can only apply to domestic firms. In the absence of mutual recognition, Member States may also impose stricter rules on foreign firms' conduct that is, for whatever reason, caught by national law.

As already hinted, substantive harmonization most often means imposing some mandatory rules across the EU and the EEA, or, more precisely, extending to all Member States rules that are already in place in a majority of them and making them "more" mandatory. This occurs for two reasons. First, there is no escape from the rules other than by incorporating in, or otherwise choosing (if at all possible) a non-EU, non-EEA jurisdiction. Second, repeal of the relevant mandatory rule will be more difficult due to the well-known phenomenon of petrification.[70]

With substantive harmonization, Member States may still deviate from the harmonized outcome, albeit in a disguised, undercover way. Member States may, in fact, fail to properly implement the harmonizing measure, or they may fail to enforce it, or, finally, their judges and enforcers may construe the harmonized measures in line with prior, more (or less) lenient national rules.[71] In other words, Member States have various ways to cheat on the EC regulatory cartel.

69. *See id.*

70. *See* Richard M. Buxbaum & Klaus J. Hopt, *Legal Harmonization and the Business Enterprise*, *in* 4 INTEGRATION THROUGH LAW 265 (Mauro Cappelletti et al. eds., 1988).

71. Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?*, 27 U. PA. J. INT'L ECON. L. 1, 12-17 (2006).

Whenever the EC measures are not purely optional or do not impose purely enabling rules on Member States, not only do they introduce EU/EEA-wide mandatory rules that are more difficult to escape from and to repeal, but they also have an impact on regulatory competition. Their presence reduces the regulatory surplus businesses can gain from (re)incorporation, thereby reducing the dynamism of the market for corporate law rules.[72]

3. Choice-of-Law-Related Harmonization

Positive harmonization can also be more directly related to choice-of-law issues. First, there are measures that aim to remove barriers to freedom of establishment or increase EU companies' cross-border mobility, thereby enhancing free choice of corporate law.[73] The most prominent example of a choice-enhancing set of rules thus far is Parliament and Council Directive 2005/56/EC (Cross-Border Merger Directive),[74] which can work as a tool for reincorporations.[75]

Second, we have measures that harmonize the procedure to be followed in order to exercise choice of law, such as safeguards for employees or creditors (so-called procedural harmonization).[76] Whenever such measures attach to other measures requiring Member States to introduce new tools for companies' mobility (as is usually the case), depending on the "proportionality" of the safeguards, they can be viewed either as what is needed in order to avoid opportunistic reincorporations or as the political price to pay for greater choice. If the measures attach to tools for companies' mobility that are already existing and effective in a sufficient number of Member States, then such measures may restrict rather than enhance free choice.[77]

72. *See* STEFANO LOMBARDO, REGULATORY COMPETITION IN COMPANY LAW IN THE EUROPEAN COMMUNITY: PREREQUISITES AND LIMITS 193 (2002).

73. *See, e.g.*, Parliament and Council Directive 2005/56/EC, Cross-Border Merger Directive, 2005 O.J. (L 310) 1 [hereinafter Cross-Border Merger Directive].

74. *Id.*

75. In the United States, reincorporations are typically made by merging the parent corporation into a shell subsidiary set up in the reincorporation state. *Cf.* Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 355 & n.90 (2001).

76. *Cf.* Simon Deakin, *Regulatory Competition Versus Harmonization in European Company Law*, *in* REGULATORY COMPETITION AND ECONOMIC INTEGRATION: COMPARATIVE PERSPECTIVES 190, 211 (Daniel C. Esty & Damien Geradin eds., 2001).

77. For instance, suppose that most Member States already allowed for cross-border mergers without requiring any involvement of employees in the process. If the EC requires Member States to involve employees, as the Cross-Border Merger Directive does, then

Finally, we have measures that directly address choice-of-law issues by harmonizing conflict-of-law rules. Depending on the connecting factor chosen for the solution of the conflict, harmonization of this kind can either promote or restrict free choice. In the former case, regulatory arbitrage is imposed from the top, which, to be sure, is almost never the case with EC harmonization. In the latter case, regulatory arbitrage is ruled out or at least restricted within the EU.

4. Prospective Harmonization

The presence of an actor like the EC, with its positive harmonization powers, may have an impact on regulatory competition and free choice no matter whether these powers are indeed exercised, provided that private parties and policymakers at the State level know that the EC may step in to react to any Member State's move to attract (re)incorporations. In two recent articles, Mark Roe has argued that the threat of federal intervention has shaped the development of U.S. corporate law much more than interstate competition.[78] This was done by creating an incentive for Delaware decisionmakers not to overstep certain boundaries beyond which corporate law would become untenable to federal decisionmakers, who are subject to different kinds of political pressures.[79]

Of course, it is theoretically conceivable that the mere prospect of European harmonization influences decision making at the national level.[80] In quite a different sense than envisioned by Professor Roe, bona fide legislators occasionally implement draft directives before they are adopted. However, it is quite unlikely for a State to be influenced in the way Roe describes. The European legislative process is relatively slow (compared to the United States Congress) and rather impervious to populist pressures, due to the absence of a common European public sphere.[81] The EU legislator has rarely, if ever, been

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harmonization hinders companies' mobility. Cross-Border Merger Directive, *supra* note 73, art. 14.

78. *See* Roe, *Delaware's Competition*, *supra* note 3, at 591; Roe, *Delaware's Politics*, *supra* note 3, at 2494.

79. *See* Roe, *Delaware's Competition*, *supra* note 3, at 591; Roe, *Delaware's Politics*, *supra* note 3, at 2494.

80. *Cf.* Roe, *Delaware's Competition*, *supra* note 3, at 644.

81. *See* Martin Gelter, *The Structure of Regulatory Competition in European Corporate Law*, 5 J. CORP. L. STUD. 247, 278-79 (2005); *see also* Luca Enriques, *Bad Apples, Bad Oranges: A Comment from Old Europe on Post-Enron Corporate Governance Reforms*,

able to gain support from businesses to enact meaningful corporate law.[82] Generally, Delaware's responsiveness to the threat of federal intervention is owed to its financial dependence on franchise revenue, which creates a powerful incentive against implementing legal rules that might put its unique position among states at risk.[83] Hence, as long as regulatory competition remains defensive and no European "Delaware" arises, there is no jurisdiction upon which supranational competition can exert significant pressure. The possibility of enacting nontrivial law may even chill nondefensive regulatory competition. One State's attempt to attract incorporations by creating significant rents by means of corporate law could just trigger a reaction by other States, which would push for harmonization.[84]

5. Summary

We have shown that in a multijurisdictional setting, the degree to which corporate law rules are mandatory depends on the degree of freedom each jurisdiction grants to private actors. States can deny their private parties' freedom of choice in corporate law, restrict it, or, finally, defer to it, with a corresponding decrease in the mandatory character of corporate law rules. This depends, of course, on how easy it is de facto to exercise free choice.

In the EU, under the impulse of the ECJ, Member States can now only restrict their citizens' free choice of corporate law within the somewhat strict boundaries that the ECJ itself has drawn in its freedom of establishment decisions.[85] This implies a relaxation of the mandatory character of corporate law rules both because at any given time private parties may opt out of local mandatory rules by opting into another State's corporate law and because, from a dynamic point of view, States may have to decrease the level of creditor and investor protection to retain corporations within their borders. Such developments may be less dramatic than they appear, however, due to

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38 WAKE FOREST L. REV. 911, 914-15 (2003) (arguing there is rarely transnational demand to create European-wide corporate law); Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1583-90 (2005) (viewing populist politics at the federal level as a serious threat to Delaware).

82. *See* Enriques, *supra* note 71, at 51.

83. Roe, *Delaware's Competition*, *supra* note 3, at 601-07, 644; *see* Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 721-22 (1987).

84. *See* Enriques, *supra* note 52, at 1269-70.

85. *See supra* notes 57-64 and accompanying text.

existing or prospective positive harmonization measures at the EC level, with regard to substantive law or conflict-of-law rules.

III. Preinsolvency Rules and Regulatory Competition in Corporate Law

We now proceed to investigate the potential for corporate law arbitrage, forum shopping, and regulatory competition in European corporate law with respect to creditor protection. Although we are ready to concede that the distinction is not clear-cut, in this Part we deal with preinsolvency rules. These are rules that operate before the onset of insolvency or, to be more precise, become operational whether the corporation goes bankrupt or not. Examples include minimum asset requirements, limits to distributions, and creditors' rights to safeguards in the event of specific transactions and disclosure. We also discuss regulatory arbitrage and regulatory competition within the EU and their implications for creditors. Then, in Part IV, we turn to postinsolvency rules, which operate only after a corporation has gone bankrupt. Before proceeding, we would like to stress that our purpose here is not to give a complete taxonomy of each and every creditor-protection instrument currently in use across the EU, but to show what room the current framework leaves for regulatory arbitrage and regulatory competition in Europe.

A. *An Overview of the Main Preinsolvency Rules from an Interjurisdictional Perspective*

Generally, preinsolvency rules follow the law of incorporation, which means that they factor into the calculus of choosing a particular state of incorporation and that they have an influence on regulatory competition in corporate law. There have been substantial efforts at positive harmonization of these rules. However, these efforts have borne little fruit thus far. First, many of these measures—in particular Council Directive 77/91/EEC (Second Directive)—apply only to public companies such as the *Aktiengesellschaft*, the *naamloze vennootschap*, the *société anonyme*, or the *società per azioni* but not to private ones.[86] Second, those measures have altered national corporate

86. *See* Council Directive 77/91/EEC, Second Company Law Directive, art. 1, 1977 O.J. (L 26) 1 [hereinafter Second Directive]. The Second Directive sets requirements for the formation of public limited liability companies and the maintenance and alteration of their capital, which Member States are required to transpose into their national laws. *Id.*

law less than one might expect. EC directives relating to corporate law generally leave a variety of options to Member States, where lawyers have frequently understood European law within the context of their respective national legal culture.[87] Those provisions of secondary European law that are mandatory are typically underenforced at the European level, allowing either Member States or corporations to circumvent them with relative ease.[88]

Conflict-of-law rules on preinsolvency rules are generally considered well-settled and thus usually considered part of corporate law. Hence, before *Centros*, the applicable legal regime would depend on either the real-seat theory or the incorporation theory.[89] Member States, especially the ones that were denying or restricting free choice of corporate law, often provided for creditor-protection measures that went far beyond the requirements of EC law. Starting with *Centros*, negative harmonization by the ECJ has resulted in "defensive regulatory competition," whereby some Member States have already started to remove rules that were apparently the outcome of isolation from competition.[90]

1. Minimum Net Assets

The Second Directive requires public corporations to have a legal capital of at least €25,000, which need not be entirely covered by assets at the time of incorporation.[91] With the Second Directive not applying to private limited companies (Ltds), Member States have

87. *See* Enriques, *supra* note 71, at 12-14.

88. *See id.*

89. *See* Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459; *cf.* William J. Carney, *Introduction* to Symposium, *Business Law: The Impact of Competition on Regulation*, 52 EMORY L.J. 1285, 1288 n.20 (2003).

90. *See* Chertok, *supra* note 29, at 495-96.

91. Second Directive, *supra* note 86, arts. 6, 9. Additional initial-capital requirements exist for credit institutions, Parliament and Council Directive 2000/12/EC, art. 5, 2000 O.J. (L 126) 1 [hereinafter Directive 2000/12/EC] (relating to the taking up and pursuit of the business of credit institutions), and insurance companies, see STEFAN GRUNDMANN, EUROPÄISCHES GESELLSCHAFTSRECHT cmt. 140, at 67 (2004). Furthermore, credit institutions are already required by European law to meet certain solvency requirements. Directive 2000/12/EC, *supra*, arts. 40-50. A recently issued directive will implement the Basel II accord, under which minimum asset requirements for investment firms and credit institutions will depend on the risk of outstanding credit. *See* Parliament and Council Directive 2006/49/EC, 2006 O.J. (L 177) 201; *see also* BASEL COMM. ON BANKING SUPERVISION, INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS: A REVISED FRAMEWORK 24-170 (2004), *available at* http://www.bis.org/publ/bcbs107.pdf.

been able to choose freely the amount for this set of corporations. This resulted in a broad variety of regulations, ranging from no such requirement in the United Kingdom, Ireland, and Cyprus to a requirement of €35,000 in Austria.[92] *Centros* has already induced France, effectively, to abolish minimum capital for private corporations,[93] and even the German Ministry of Justice proposed a reduction from €25,000 to €10,000.[94]

The effectiveness of minimum capital requirements in actually protecting creditors are highly doubtful for reasons that need not be reiterated here.[95] Even some supporters of legal capital requirements concede that their function does not lie in protecting creditors from the risk of substantial losses resulting from an unfavorable business development, but rather in signaling seriousness to the market; thus, this erects a barrier against the creation of dubious corporations with an unreasonable amount of backing by shareholders.[96] However, if

92. Gesetz über Gesellschaften mit beschränkter Haftung [GmbHG] [Limited Liability Company Act] Reichsgesetzblatt [RGBl.] No. 58/1906, §§ 6(1), 10(1) (Austria); *see* Carsten Frost, *Transfer of Company's Seat—An Unfolding Story in Europe*, 36 VICT. U. WELLINGTON L. REV. 359, 372-73 (2005). To be sure, only €17,500 needs to be paid in cash before the corporation is registered (or the lower total amount of cash contributions, which is permissible if there are contributions in kind for which the consideration has to be transferred in full). Limited Liability Company Act, *supra*, § 10(1).

93. Law No. 2003-721 of Aug. 1, 2003, Journal Officiel de la République Français [J.O.] [Official Gazette of France], Aug. 5, 2003, p. 13,449, art. 1; *see* Eva-Maria Kieninger, *The Legal Framework of Regulatory Competition Based on Company Mobility: EU and US Compared*, 6 GERMAN L.J. 741, 768 (2004).

94. For the most recent legislative draft, see Referentenentwurf: Entwurf eines Gesetzes zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) art. 1(3) (2006), *available at* http://www.bmj.bund.de/media/archive/1236.pdf [hereinafter MOMIG]. For a discussion of earlier proposals, see Massimo Miola, *Legal Capital and Limited Liability Companies: The European Perspective*, 2 EUR. COMPANY & FIN. L. REV. 413, 445-46 (2005); Wolfgang Zöllner, *Konkurrenz für inländische Kapitalgesellschaften durch ausländische Rechtsträger, insbesondere durch die englische Private Limited Company*, 97 GMBH-RUNDSCHAU [GMBHR] 1, 11 (2006).

95. *See* John Armour, *Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law*, 63 MOD. L. REV. 355, 371-72 (2000); Enriques & Macey, *supra* note 14, at 1185-88; Peter O. Mülbert & Max Birke, *Legal Capital—Is There a Case Against the European Legal Capital Rules?*, 3 EUR. BUS. ORG. L. REV. 695, 732 (2002).

96. *See* Marcus Lutter, *Gesetzliches Garantiekapital als Problem europäischer und deutscher Rechtspolitik*, 43 AG 375, 375 (1998); Hanno Merkt, *Das Centros-Urteil des Europäischen Gerichtshofs*, *in* 2 GESELLSCHAFTSRECHT IN DER DISKUSSION 1999, at 111, 138 (Gesellschaftsrechtlichen Vereinigung ed., 2000); Friedrich Rüffler, *Gläubigerschutz durch Mindestkapital und Kapitalerhaltung in der GmbH—überholtes oder sinnvolles Konzept?*, 2 GESELLSCHAFTS- UND STEUERRECHT AKTUELL [GES] 140, 146 (2005); Rüdiger Wilhelmi, *Das Mindestkapital als Mindestschutz—eine Apologie im Hinblick auf die Diskussion um eine Reform der GmbH angesichts der englischen Limited*, 97 GMBHR 13, 13-14 (2006); *see also*

there are any benefits to this argument, they need to be weighed against the disadvantages of preventing the formation of potentially thriving companies backed by a sound business idea but little or no assets.

The *Centros-Inspire Art* line of decisions has made it impossible for national legislators to impose minimum asset requirements on pseudo-foreign corporations.[97] Thus, the possibilities for corporate law arbitrage in this field are nearly unrestricted.[98] In fact, minimum capital has become one of the most important factors driving the incorporation of continental businesses in the United Kingdom. As already seen, this has prompted some "defensive regulatory competition" across the EU.[99] It is fairly easy to predict that the final outcome of this process will be the practical elimination of minimum capital requirements.

2. Restrictions on Distributions

In the EU, legal rules limiting managers' discretion over the declaration of dividends or any other way of conveying corporate assets to shareholders are intertwined with the regulation of legal capital.[100] Under article 15(1) of the Second Directive, no distributions to shareholders may be made when net assets are lower or would become lower than subscribed capital plus certain reserves which may not be distributed, except in the case of a reduction of subscribed capital.[101] Even if this does not protect creditors against regular business risk, a public corporation will, in principle, be unable to

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GRUNDMANN, *supra* note 91, cmt. 328; Wolfang Schön, *The Future of Legal Capital*, 5 EUR. BUS. ORG. L. REV. 429, 436-39 (2004).

97. *See* Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., 2003 E.C.R. I-10,155; Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459.

98. *See* Ulrich Forsthoff & Martin Schulz, *Gläubigerschutz bei EU-Auslandsgesellschaften*, *in* GRENZÜBERSCHREITENDE GESELLSCHAFTEN § 15 cmt. 27 (Heribert Hirte & Thomas Bücker eds., 2005); Stefan Grundmann, *Regulatory Competition in European Company Law—Some Different Genius?*, *in* CAPITAL MARKETS IN THE AGE OF THE EURO, *supra* note 56, at 561, 583-84.

99. *See supra* Part II.A.4.

100. Of course, this does not necessarily have to be the case because restrictions on distributions may also be related to balance sheets in the absence of legal capital rules or not be related at all with balance-sheet data, as when a solvency test is required. *See* MODEL BUS. CORP. ACT § 6.40(c) (2002). Even the prohibition of concealed distributions, described *infra* text accompanying notes 108-116, could conceivably apply in the absence of legal capital.

101. Second Directive, *supra* note 86, art. 15(1).

convey funds to shareholders if net assets fall below the subscribed capital, unless shareholders vote to go through a capital-reduction procedure which includes certain safeguards for creditors.[102] Reduction below the minimum capital is of course ruled out entirely.[103] As a remedy, article 16 of the Second Directive requires that distributions received must be returned if the corporation proves that these shareholders knew of the irregularity "or could not in view of the circumstances have been unaware of it."[104]

However, two important caveats need to be mentioned. First, the actual computation of net assets within the meaning of the directive is basically a balance-sheet test on the basis of the last financial year's annual accounts. Thus, the extent of "capital maintenance" depends on the applicable accounting rules. In spite of Council Directive 78/660/EEC (Fourth Directive), which on its face, harmonizes accounting law in great detail,[105] a considerable number of elective provisions have allowed EU Member States to uphold their national accounting cultures.[106] However, the recent International Accounting Standards (IAS) regulation gives Member States the choice between an accounting system based on the Fourth Directive, or one on International Financial Reporting Standards (IFRS, formerly known as IAS) for individual accounts.[107]

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102. *Id.* arts. 30-39.

103. *Id.* art. 34.

104. *Id.* art. 16.

105. Council Directive 78/660/EEC, Fourth Company Law Directive, 1978 O.J. (L 222) 11 [hereinafter Fourth Directive].

106. *E.g.*, Werner F. Ebke, *Accounting, Auditing, and Global Capital Markets, in* CORPORATIONS, CAPITAL MARKETS, AND BUSINESS IN THE LAW: LIBER AMICORUM RICHARD M. BUXBAUM 113, 119 (Theodor Baums et al. eds., 2000); Martin Gelter & Mathias M. Siems, Recent Development, *Judicial Federalism in the ECJ's* Berlusconi *Case: Toward More Credible Corporate Governance and Financial Reporting?*, 46 HARV. INT'L L.J. 487, 505 (2005); *see also* Axel Haller, *International Accounting Harmonization: American Hegemony or Mutual Recognition with Benchmarks? Comments and Additional Notes from a German Perspective*, 4 EUR. ACCT. REV. 235, 237 (1995) ("The new accounting rules were interpreted in the light of the existing German accounting model . . . .").

107. Parliament and Council Regulation No. 1606/2002, art. 5(a), 2002 O.J. (L 243) 1. Member States are also allowed to delegate this choice to firms. *See* Martin Gelter, *Kapitalerhaltung und internationale Rechnungslegung*, 33 DER GESELLSCHAFTER 177, 179-85 (2004) (Austria) (showing the incompatibility between specific fundamental principles of IFRS accounting and the Second Directive, as interpreted in German-speaking countries); Wolfgang Schön, *Gesellschafter-, Gläubiger- und Anlegerschutz im Europäischen Bilanzrecht*, 29 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT [ZGR] 706, 720-21 (2000) (F.R.G.) (arguing that a "dynamic interpretation" of European accounting directives to conform to IAS would neglect the necessary regard for creditor protection); Wolfgang Schön, *Internationalisierung der Rechnungslegung und Gläubigerschutz*, 54 DIE

Second, as a practical matter, it is not entirely clear to what kind of transactions the prohibition applies. While the Second Directive explicitly speaks only of "distributions," German commentators generally agree that so-called concealed distributions (*verdeckte Ausschüttungen* or *verdeckte Einlagenrückgewähr*)[108] are also prohibited.[109] This term refers to transactions in which corporate funds are conveyed to shareholders indirectly, typically through contracts entered into on unfair terms, such as loans to shareholders with unusually low (or no) interest rates or purchases from shareholders at excessive prices.[110] One argument in favor of such a doctrine uses article 42 of the Second Directive, which requires equal treatment of shareholders under equal conditions.[111] More importantly, if the prohibition is to be effective, it does not matter whether a distribution is made through the official declaration of dividends or in any other way.[112] Naturally, the German understanding of the Second Directive is shaped by the extensive German case law on concealed distributions to shareholders,[113] which, among other things, covers issues such as guarantees for a shareholder's personal debt by the corporation.[114] However, because the Second Directive only applies to public corporations, German law totally prohibits concealed distributions in *Aktiengesellschaften*,[115] while in GmbHs concealed distributions are

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WIRTSCHAFTSPRÜFUNG (SPECIAL ISSUE) 74, 76 (2001) (F.R.G.) (arguing that IAS accounting shifts risk from shareholders to creditors); *see also* Eilís Ferran, *The Place for Creditor Protection on the Agenda for Modernisation of Company Law in the European Union*, 3 EUR. COMPANY & FIN. L. REV. 178, 208-11 (2006) (discussing the question of compatibility between the Second Directive and IFRS accounting).

108. *See* UWE HÜFFER, AKTIENGESETZ § 57 (6th ed. 2004).

109. *See* GRUNDMANN, *supra* note 91, cmt. 343; MATHIAS HABERSACK, EUROPÄISCHES GESELLSCHAFTSRECHT cmt. 167, at 123 (2d ed. 2003); GÜNTER CHRISTIAN SCHWARZ, EUROPÄISCHES GESELLSCHAFTSRECHT cmt. 596, at 379-80 (2000); Peter O. Mülbert, *Kapitalschutz und Gesellschaftszweck bei der Aktiengesellschaft*, *in* FESTSCHRIFT FÜR MARCUS LUTTER ZUM 70. GEBURTSTAG 535, 545-47 (Uwe H. Schneider et al. eds., 2000).

110. *See* Holger Fleischer, *Disguised Distributions and Capital Maintenance in European Company Law*, *in* LEGAL CAPITAL IN EUROPE 94 (Marcus Lutter ed., 2006).

111. GRUNDMANN, *supra* note 91, cmt. 343.

112. *See* Fleischer, *supra* note 110, at 100 (arguing that the purpose of articles 15 and 16 implies a general prohibition of concealed distributions); Mülbert, *supra* note 109, at 546-47 (same); Wolfgang Schön, *Deutsches Konzernprivileg und europäischer Kapitalschutz—ein Widerspruch?*, *in* FESTSCHRIFT FÜR BRUNO KROPFF: AKTIEN- UND BILANZRECHT 285, 294 (Karl-Heinz Forster et al. eds., 1997) (same).

113. *See supra* note 108 and accompanying text.

114. *See* BGH Nov. 24, 2003, 157 BGHZ 72.

115. German commentators typically argue that because article 15(1)(c) of the Second Directive limits distributions to profits, distributions other than through dividends are

permitted as long as they do not reduce net assets below the statutory capital requirement.[116]

By contrast, under English law a distribution is normally defined as a transfer of assets without consideration.[117] Still, in a vein similar to the German doctrine, English courts have held the following to be unauthorized returns of capital: excessive remuneration of directors,[118] undervalued transfers of real property to another corporation owned by the same parent,[119] and guarantees for other firms within the same group.[120] However, transactions that are not a complete sham will not be considered a "distribution" at all,[121] meaning that, other than under German law, a subjective element is required to void a transaction.[122] The recent Company Law Reform allows distributions in kind as long as there are sufficient profits available for distributions to cover the difference between the asset's book value and the consideration received, which would not be acceptable under German law.[123] Given

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prohibited. *See, e.g.*, HABERSACK, *supra* note 109, cmt. 164, at 121; SCHWARZ, *supra* note 109, cmt. 596, at 379-80.

116. Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, Bundesgesetzblatt, Teil I [BGBl. I] at 1089, as amended by Gesetz, Dec. 21, 2006, BGBl. I at 3332, art. 3, § 57, *translated in* BUSINESS TRANSACTIONS IN GERMANY app. 7-1 (Dennis Campbell ed., 2006); GmbHG [Limited Liability Company Act], Apr. 20, 1892, Reichsgesetzblatt [RGBl.] at 477, as amended by Gesetz, Mar. 22, 2005, BGBl. I at 837, art. 12, § 30, *translated in* BUSINESS TRANSACTIONS IN GERMANY, *supra*, app. 6-26; *cf.* MARCUS LUTTER & PETER HOMMELHOFF, GMBH-GESETZ: KOMMENTAR § 30 cmt. 3 (Walter Bayer et al. eds., 16th ed. 2004). By contrast, under Austrian corporate law, which usually strongly resembles German law, concealed distributions are generally illegal in both types of corporations. *See* AktG BGBl. No. 98/1965, § 52 (Austria); GmbHG RGBl. No. 58/1906, § 82 (Austria); *see also* Fleischer, *supra* note 110, at 105-06.

117. *See* Clydebank Football Club Ltd v. Steedman, 2002 S.L.T. 109 (Sess.) (Scot.); Richard Morris, *Dividends*, *in* 1 PALMER'S COMPANY LAW paras. 9.701, .705 (Geoffrey Morse et al. eds., 25th ed. 2002); John Armour, *Avoidance of Transactions as a 'Fraud on Creditors' at Common Law*, *in* VULNERABLE TRANSACTIONS IN CORPORATE INSOLVENCY para. 7.38 (John Armour & Howard Bennett eds., 2003).

118. *In re* Halt Garage (1964) Ltd, [1982] 3 All E.R. 1016, 1042-45 (Ch.) (Eng.).

119. *See* Aveling Barford Ltd v. Perion Ltd, [1989] B.C.L.C. 626 (Ch.) (Eng.); *see also* M.J. Burke, *Shareholder Ratification of Directors' Actions*, 140 NEW L.J. 240, 241 (1990).

120. *See* Barclays Bank plc v. British & Commonwealth Holdings plc, [1996] 1 B.C.L.C. 1, 9-10 (Ch.) (Eng.); *cf.* PAUL L. DAVIES, GOWER AND DAVIES' PRINCIPLES OF MODERN COMPANY LAW 279-80 (7th ed. 2003); MICHAEL FORDE, COMPANY LAW para. 7-31, at 291 (3d ed. 1999); Eva Micheler, *Gläubigerschutz im englischen Gesellschaftsrecht*, 33 ZGR 324, 328-29 (2004).

121. Armour, *supra* note 117, para. 7.38.

122. *See* Fleischer, *supra* note 110, at 101-02. For a detailed comparison, see Thomas Bachner, Creditor Protection in Private Companies—Anglo-German Perspectives after Centros (2006) (unpublished Ph.D. dissertation, Cambridge University) (on file with author) (see especially chapter 3 on capital maintenance and unlawful distributions).

123. Companies Act 2006, c. 46, § 845 (U.K.).

that the English case law on this subject is sparse, and, even more importantly, commentators appear not to see a connection with the Second Directive, it is obvious that the understanding of constraints on distributions imposed by EC law differs considerably.[124] On top of that, concealed distributions do not appear to be much of an issue in some other countries.[125]

Because restrictions on distributions, including concealed distributions, may result in significant cost (e.g., when planning intragroup transactions to avoid violations of such rules) and considerable risk to shareholders if the corporation goes bankrupt, differences in the law may affect corporate arbitrage decisions to some degree.[126] Following *Centros* and *Inspire Art*, there appears to be widespread agreement that capital-maintenance rules of the state of incorporation apply, and choice of law with respect to distributions will therefore be possible.[127]

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124. For example, Vanessa Edwards discusses neither the English nor the German cases in her treatise. *See* VANESSA EDWARDS, EC COMPANY LAW 69 (1999). The Rickford report discusses the issue only briefly within the context of German law. *See* Jonathan Rickford, *Reforming Capital: An Introductory Note*, 15 EUR. BUS. L. REV. 919, 1008 (2004).

125. For France, see MICHEL GERMAIN, 1:2 TRAITÉ DE DROIT COMMERCIAL 607-09 (G. Ripert & R. Roblot eds., 18th ed. 2002) (discussing the issue of "dividends fictifs" under French Law and ignoring the issue of concealed distributions); *see also* Fleischer, *supra* note 110, at 102-04. For Spain, see José Massaguer Fuentes, *Utili, Riserve e Dividendi*, *in* 2 ARMONIE E DISARMONIE NEL DIRITTO COMUNITARIO DELLE SOCIETÀ DI CAPITALI 1115, 1129-32 (Gian Franco Campobasso ed., 2003) (similar to France, but for Spanish law). For Italy, a distinction has to be made between concealed distributions and concealed restitutions of contributions. The former does not appear to be an issue. *See, e.g.*, Giovanni E. Colombo, *Il bilancio d'esercizio*, *in* 7* TRATTATO DELLE SOCIETÀ PER AZIONI, *supra* note 55, at 23, 535-44 (providing a thorough analysis of the Italian provision, Royal Decree, No. 262 of mar. 16, 1942 art. 2433, para. 4, Gazz. Uff., apr. 4, 1942, No. 79, which corresponds to article 16 of the Second Directive, and discussing the relationships between the two, but totally ignoring the problem of concealed distributions). To be sure, until 2002, it was a crime to distribute "in any form" fictitious profits, and the relevant provision was construed as including the case of concealed distributions. C.C. art. 2621. After the 2002 reform, however, the criminal provision was reformulated without the "in any form" clause and, in the absence of case law so far, it is widely construed as not including concealed distributions any more. *See, e.g.*, Valerio Napoleoni, *Le disposizioni penali in materia di società e di consorzi*, *in* CODICE COMMENTATO DELLE NUOVE SOCIETÀ 1690, 1773 (G. Bonfante et al. eds., 2004). There is, however, some scholarly debate, and a couple of court decisions can be found with regard to concealed restitutions of contributions, a phenomenon partially overlapping with concealed distributions. *See, e.g.*, Marco S. Spolidoro, *I conferimenti in danaro*, *in* 1** TRATTATO DELLE SOCIETÀ PER AZIONI, *supra* note 55, at 247, 349-61 (2004) (not referencing, however, EC law).

126. *Cf.* Mülbert & Birke, *supra* note 95, at 720-21 (conceding that creditors may look favorably at rules against concealed distributions that, however, come at a significant cost).

127. *E.g.*, Forsthoff & Schulz, *supra* note 98, cmt. 32. *Contra* Altmeppen, *supra* note 64, at 97, 102.

3. Creditors' Right to Safeguards in the Event of Significant Transactions

Jurisdictions sometimes protect creditors by granting them a right to obtain some form of safeguard in the event the corporate debtor executes a transaction supposedly capable of increasing the risk faced by the creditor. This tool has also been used by EC corporate law with regard to a few transactions, reflecting the fact that some Member States already provided for similar safeguards prior to harmonization.[128]

First of all, the Second Directive provides that in the event of a reduction of capital,

> [a]t least the creditors whose claims antedate the publication of the decision to make the reduction shall be entitled at least to have the right to obtain security for claims which have not fallen due by the date of that publication. The laws of a Member State shall lay down the conditions for the exercise of this right.[129]

Further, such laws "may not set aside such right unless the creditor has adequate safeguards, or unless the latter are not necessary in view of the assets of the company."[130]

Second, "an adequate system of protection" for the interests of creditors has to be devised by Member States in the case of mergers and divisions falling under Council Directive 78/855/EEC (Third Directive) and Council Directive 82/891/EEC (Sixth Directive).[131] Such provisions also apply to the formation of a European company by merger[132] and to cross-border mergers.[133] In many Member States, the system of protection is very similar to the one designed in article 32 of the Second Directive for reductions of capital.[134]

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128. For instance, in Italy, provisions similar to those on reduction of capital were already present in the 1942 version of the Civil Code. C.c. arts. 2445, 2503 (relating to reductions of capital and mergers respectively). For Germany, see AktG, Sept. 6, 1965, BGBl. I at 1089, §§ 225, 347.

129. Second Directive, *supra* note 86, art. 32.

130. *Id.*

131. *See* Council Directive 78/855/EEC, Third Company Law Directive, art. 13, 1978 O.J. (L 295) 36 [hereinafter Third Directive]; Council Directive 82/891/EEC, art. 12, 1982 O.J. (L 378) 47.

132. Council Regulation 2157/2001, art. 24, 2001 O.J. (L 294) 1 (EC).

133. Cross-Border Merger Directive, *supra* note 73, art. 2, para. 2.

134. *Compare* CODE DE COMMERCE [C. COM.] art. L236-14 (Fr.); Umwandlungsgesetz [UmwG], Oct. 28, 1994, BGBl. I at 3210, as amended, Gesetz, Nov. 10, 2006, BGBl. I at 2553, art. 8, § 22 (F.R.G.); C.c. art. 2503 (Italy); CÓDIGO DAS SOCIEDADES COMERCIAIS arts. 101-A, 101-B, Decreto No. 76-A/2006 de 29 de marzo de 2006 (Port.); *and* art. 243 of the

In general, the relevance of such provisions for creditor-protection purposes can hardly be underestimated. To begin with, as one of the authors has argued elsewhere, all such provisions are either timidly market-mimicking or unimportant.[135] These provisions are timidly market-mimicking "with regard to sophisticated creditors, who normally reserve the far more effective right to veto such transactions (usually in broader and more detailed terms) or insert an acceleration clause applying if these transactions are entered into."[136] They are unimportant with regard to other (voluntary) creditors,[137] either because these are weak creditors and, hence, lack the negotiating power to exercise their right vis-à-vis the corporation or because they have such power, in which case they do not need a right to obtain safeguards.[138]

Further, with specific regard to the EC measures, the Third and the Sixth Directives altogether are arguably trivial as long as at least one Member State, namely the United Kingdom, lets its companies execute mergers and divisions under a different set of rules.[139]

4. Mandatory Disclosure

One of the most important elements, or possibly the dominant element, of EC corporate law is its extensive regime of disclosure.[140] Council Directive 68/151/EEC (First Directive) provides for the

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Ley de Sociedades Anónimas [L.S.A.] [Law on Public Corporations] (Repertorio Aranzadi Cronológico [R.C.L.] 1989, 1564) (Spain), *with* Second Directive, *supra* note 86, art. 32.

135. *See* Enriques, *supra* note 71, at 33-34.

136. *Id.* at 34.

137. Creditor-safeguard provisions may matter to involuntary creditors, provided that a number of conditions apply. First, involuntary creditors should have no other meaningful relationship with the corporation. Second, legal systems should provide for effective ways for them to become informed about the relevant transaction so as to be able to exercise their right in a timely fashion. Finally, the exercise of such a right must be cheap compared with the expected loss stemming from the increased risk of default following the transaction. In countries where creditors need to act in court in order to obtain the relevant safeguard (as is the case in Italy), and where no means exists to coordinate the efforts of the numerous creditors that, for example, are the victims of a mass tort, the cost of exercising the right is likely to be too high most of the time. *See* Carlo Santagata, *Le fusioni*, *in* 7** TRATTATO DELLE SOCIETÀ PER AZIONI, *supra* note 55, at 3, 527 (2004).

138. Enriques, *supra* note 71, at 35-36. "[S]uch provisions do not require that the company obtain creditors' consent to execute certain transactions. They require creditors to activate in order to obtain protection, thus making it less plausible that a bargaining problem connected with an endowment effect will arise." *Id.* at 36 n.145.

139. *See id.* at 33.

140. *Cf.* Stefan Grundmann, *The Structure of European Company Law: From Crisis to Boom*, 5 EUR. BUS. ORG. L. REV. 601, 617 (2004) ("Information rules dominate European company law . . . .").

disclosure of a variety of corporate data, but mostly for disclosure of data about the corporation's annual accounts and consolidated accounts.[141] The preambles to both the Fourth Directive and Council Directive 83/349/EEC (Seventh Directive) refer to the interests of third parties (obviously including creditors) to justify mandatory disclosure of accounting information.[142] Mandatory disclosure is of particular significance for small creditors who lack the bargaining power to force the voluntary provision of information and who may even be nonadjusting creditors who are not in the position to alter contract terms depending on risk of default.

However, there are good reasons to doubt whether the enforcement mechanisms of EC law for mandatory disclosure provisions are effective. In 1997 and 1998, the ECJ ruled that Germany had failed to adequately enforce disclosure requirements for small companies.[143] The ruling sparked a German reform act imposing a new regime of sanctions.[144] Nevertheless, recent empirical evidence shows that more than ninety percent of German firms still fail to comply,[145] although the newly enacted law on the electronic commercial register may increase the effectiveness of enforcement.[146]

A related issue, recently tackled by the ECJ in the *Berlusconi* case, is accounting fraud.[147] Even though there are no explicit provisions addressing the issue in the company law directives, Advocate General (AG) Juliane Kokott sweepingly suggested that community law requires Member States to impose effective, proportionate, and dissuasive penalties.[148] Further, AG Kokott argued that false disclosure is at least as harmful as nondisclosure which is

141. *See* Council Directive 68/151/EEC, First Company Law Directive, art. 2, 1968 O.J. (L 65) 8.

142. *See* Fourth Directive, *supra* note 105, pmbl.; Council Directive 83/349/EEC, Seventh Company Law Directive, 1983 O.J. (L 193) 1.

143. *See* Case C-97/96, Verband deutscher Daihatsu-Händler eV v. Daihatsu Deutschland GmbH, 1997 E.C.R. I-6843, I-6865, I-6867; Case C-191/95, Commission v. Federal Republic of Germany, 1998 E.C.R. I-5449, I-5505.

144. Kapitalgesellschaften- und Co-Richtlinie-Gesetz [KapCoRiLiG], Feb. 24, 2000, BGBl. I at 154 (F.R.G.) (introducing, among other things, penalties imposed upon request by a shareholder, creditor, or the works council).

145. Franz Jürgen Marx & Holger Dallmann, *Jahresabschlusspublizität mittelständischer Unternehmen*, 59 BB 929 (2004).

146. Gesetz über elektronische Handelsregister und Genossenschaftsregister sowie das Unternehmensregister [EHUG], Nov. 10, 2006, BGBl. I at 2553, art. 1 (F.R.G.).

147. Joined Cases C-387, C-391 & C-403/02, Berlusconi, 2005 E.C.R. I-3565.

148. *See id.* paras. 67-81 (opinion of AG Kokott).

covered by the directives.[149] The ECJ agreed with this assessment in principle, but decided in favor of the defendants on the basis of a rather formalistic understanding of the *nulla poena sine lege* principle, which forms an integral part of community law.[150] Still, European law could, in theory, have an impact on the interests of creditors in that it ensures the accuracy of financial statements.

However, various factors compromise the actual usefulness of disclosure to creditors. Besides the issue of differences in applicable accounting standards[151] and the lack of enforcement of disclosure in some Member States, it is important to note the directives' failure to provide a specific period after the end of the fiscal year within which disclosure must occur. Member States sometimes prescribe relatively generous filing periods. Examples include: nine months in the United Kingdom for Ltds,[152] twelve months in Germany,[153] nine months in Austria,[154] and seven months in Italy and Spain.[155] At that point, accounting information is, of course, already rather stale.

Thus, at least for small corporations, the European regime of mandatory disclosure may bring fewer benefits than it appears at first glance. Most of the justifications for mandatory disclosure commonly advanced in the literature, which relate to the character of information as a public good and its underproduction and mispricing in an unregulated market, are understandable only within the context of publicly traded firms.[156] For important creditors, such as banks, information provided by mandatory disclosure under the regime of the directives is of little significance because creditors are usually able to gain access directly through the firm's managers.[157] Trade creditors will often not have the bargaining power to make similar requests. Therefore, they resort to others ways of obtaining information about

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149. *See id.* For an analysis of that opinion, see Gelter & Siems, *supra* note 106, *passim*.

150. *See Berlusconi*, 2005 E.C.R. paras. 63, 66-69 (court opinion).

151. *See supra* Part III.A.2.

152. Companies Act, 2006, c. 46, § 442(2)(a) (U.K.).

153. Handelsgesetzbuch [HGB] [Commercial Code], May 10, 1897, RGBl. 219, as amended, § 325(1) (F.R.G.).

154. Handelsgesetzbuch [HGB] [Commercial Code], Mar. 1, 1939, Gesetzblatt für das Land Österreich [GblÖ] No. 83/1939, as amended, § 277(1) (Austria).

155. For Italy, see C.c. art. 2435 in connection with C.c. art. 2365(2). For Spain, see articles 95, 171, and 218 of the L.S.A. (R.C.L. 1989, 1564).

156. For a succinct overview, see Gerard Hertig, Reinier Kraakman & Edward Rock, *Issuers and Investor Protection*, *in* KRAAKMAN ET AL., *supra* note 53, at 194, 204-07.

157. *See* ULRICH NOACK, UNTERNEHMENSPUBLIZITÄT cmt. 104, at 40 (2002).

the firm, or they will take out bad-debt insurance, while mandatory disclosure is of little (if any) relevance to them.[158] The mandatory disclosure regime imposed by the directives may, in effect, be doing as little as ensuring the implementation of unitary accounting systems and standards within the respective country.

Still, accounting and disclosure provisions are a factor potentially influencing regulatory competition. From the perspective of conflict-of-law rules, most authors seem to agree that accounting duties follow corporate law.[159] For example, an English Ltd should follow U.K. accounting rules. Quite obviously, the ECJ would hardly tolerate a Member State applying its own accounting law to foreign companies, given extensive European harmonization.[160] This view is confirmed by the new audit directive, which implements the principle of home-country regulation.[161] The doctrine identifies as the applicable law the one of the Member State in which the auditor is approved and in which the audited entity has its registered office.[162]

However, accounting is probably one of the few areas (the only one?) where the founders of a corporation will usually not want to opt out of their home state's corporate law regime. This is because drawing up financial statements under a familiar system is easier and less costly and because the home system will be harmonized with the applicable tax law. Apparently, because the Companies House does not investigate the substantive content of financial statements, it has become common practice for English Ltds with their seat of administration in Germany to submit accounts set up under the accounting provisions of the German commercial code.[163]

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158. *But see id.* (claiming without reference that in the United Kingdom disclosed accounts are frequently inspected before a company enters into large business transactions).

159. *See, e.g.*, Martin Gelter, *Rechnungslegungspflicht der englischen* limited *mit Sitz in Österreich*, 23 ÖSTERREICHISCHES RECHT DER WIRTSCHAFT 134, 134-35 (2005) (Austria); Bodo Riegger, *Centros—Überseering—Inspire Art: Folgen für die Praxis*, 33 ZGR 510, 515-17 (2004); André O. Westhoff, *Rechnungslegung*, *in* GRENZÜBERSCHREITENDE GESELLSCHAFTEN, *supra* note 98, § 17 cmts. 31-34.

160. *See* Gelter, *supra* note 159, at 135; Markus Rehberg, *Zivil-, Handels- und Verfahrensrecht*, *in* AUSLÄNDISCHE KAPITALGESELLSCHAFTEN, *supra* note 64, § 5 cmt. 114, at 165.

161. Parliament and Council Directive 2006/43/EC, art. 34(1), 2006 O.J. (L 157) 87.

162. *See id.* On damages claims against the auditor, see Werner F. Ebke, *§ 323 HGB*, *in* 4 MÜNCHENER KOMMENTAR ZUM HANDELSGESETZBUCH cmts. 148-168 (Karsten Schmidt ed., 2001).

163. Westhoff, *supra* note 159, cmt. 111.

For large listed firms, IFRS/IAS has become the accounting system of choice with the EC "IAS Regulation."[164] However, the debate on accounting provisions for small firms is far from over. Accounting standards may, therefore, be one of the factors affecting a corporate law arbitrage decision.

B. *Corporate Law Arbitrage and Regulatory Competition*

We have seen that the ECJ has largely opened the field to corporate law arbitrage. While there have been efforts at positive harmonization, mostly concerning public corporations, they have remained largely ineffective and therefore do not significantly curb regulatory arbitrage.[165] As described above, preinsolvency rules are mostly the domain of corporate law, much more so than in the United States where creditor protection is not really an issue for corporate legislators—except for restrictions on dividends, which are mostly meaningless and prone to circumvention.[166] By contrast, in Europe, creditor protection has long been a concern of corporate law. Hence, it comes as no big surprise that the American discussion on regulatory competition has little to offer on concerns of creditor protection.[167]

We now proceed to assess the intensity of regulatory competition within the EU today and how it is to be interpreted. Then we analyze how *ex ante* and *ex post* choice-of-law decisions affect creditors. By *ex ante* and *ex post* decisions we mean the decision to incorporate or to reincorporate before or after credit has been extended to the firm.

164. *See supra* note 107 and accompanying text.

165. However, the risk that the EC may harmonize a given corporate law issue, making the law of a Member State particularly attractive, may hinder regulatory arbitrage if companies perceive that there is a high chance that a sufficient number of (re)incorporations in that Member State will prompt harmonization, thereby making the choice of that corporate law unattractive *ex post*. *See supra* note 84 and accompanying text.

166. *See* ROBERT CHARLES CLARK, CORPORATE LAW 618 (1986) (describing the possibility of increasing surplus by reevaluating assets or changing accounting policies); BAYLESS MANNING WITH JAMES J. HANKS, JR., LEGAL CAPITAL 93 (3d ed. 1990) ("Whether one views it as a blessing or a deficiency of the existing statutory systems, it is at least a fact that the corporation acts do not pursue the implementation of their own scheme with any real seriousness."). The elimination or vestigialization of legal-capital rules has arguably been the outcome of regulatory competition. Richard A. Booth, *Capital Requirements in United States Corporation Law*, *in* LEGAL CAPITAL IN EUROPE, *supra* note 110, at 620, 622, reports that "many observers have suggested that the dilution of substantive rules such as those relating to legal capital may be attributable to destructive competition" among States and suggests that, to the contrary, "it may also be the case that such rules proved to be inefficient and that other more efficient rules have evolved."

167. The only exception seems to be Bebchuk, *supra* note 2, at 1489-90 (discussing involuntary creditors).

1. Corporate Law Arbitrage and Regulatory Competition So Far

We have seen some regulatory arbitrage with respect to preinsolvency rules is already happening, driven mostly by minimum capital requirements and that possibly can, at least partly, be credited for a trend toward the abolition of minimum capital requirements in some countries.[168] Still, it would probably be premature to infer any long-term trends from this. Of course, legal capital requirements are usually seen as an instrument of creditor protection. However, if minimum capital requirements do not actually help creditors and rational creditors should not care about them, then the changes in the law induced by corporate law arbitrage so far are not really an issue of creditor protection, but rather a removal of administrative slack affecting only the interests of the founders of new companies. If it is true that only one interest group is affected, and this group is affected in a positive way, it seems hard to doubt that the effect of regulatory competition is beneficial as well. Given the minor relevance of this issue from the perspective of creditors, however, this recent development should not be construed as evidence of either a "race to the top" or a "race to the bottom" with respect to creditor protection.

2. *Ex Ante* Choice of Law

Even in light of doubts about whether each of the current creditor-protection mechanisms implemented by the Member States actually serves the interests of creditors, it is hard to rule out entirely that some of them serve these interests. Conceivably, Member States could also devise new mechanisms that do. Hence, we ask whether regulatory competition is likely to lead to the retention and development of mechanisms creditors actually care about, i.e., whether corporate law arbitrage will be beneficial.

Corporate debtors, especially when the corporation approaches insolvency, have powerful incentives to act in ways that are detrimental to creditors. This incentive arises because shareholders capture most of the potential gains of increased risk, whereas creditors, whose entire benefits are limited to the amount of principal plus interest stipulated *ex ante*, have to bear most of the risk of failure.[169] To counter this

168. *See* Miola, *supra* note 94, at 441-47.

169. *See* Stewart C. Myers, *Determinants of Corporate Borrowing*, 5 J. FIN. ECON. 147, 147-49, 160 (1977).

danger, creditors frequently request contractual clauses limiting the opportunism of debtors[170] or charge a risk-adjusted interest rate.[171]

Hence, in line with the standard corporate law-and-economics literature, which considers corporate law to be a standard-form contract, the applicable regime of corporate law also needs to be seen as part of the contract of lending.[172] At least some corporate law creditor-protection tools will affect the creditor's assessment of shareholder and manager opportunism; to the extent that corporate law reduces this risk, the creditor will charge a lower interest rate or find it unnecessary to add protective covenants to the lending agreement. For example, a rational creditor will take the possibility of veil piercing or equitable subordination into account and adjust the interest rate accordingly, considering the reduced risk, even if only marginally. Similarly, creditors should make some adjustment depending on the ability of managers and shareholders to remove assets from the corporation, thus increasing the likelihood of insolvency and reducing the chances of recovery (called asset diversion). It follows that rules impeding such transactions, including concealed-distribution doctrines or mandatory disclosure rules, should also affect creditors' decision on the margin. Thus, assuming the ability to accurately assess risk of default and to adjust prices and conditions accordingly, creditors should be getting precisely what they bargained for in terms of *ex ante* expectations.

A creditor may want a corporate debtor to observe a specific Member State's creditor-protection regime. A powerful institutional lender could theoretically even have the bargaining power to induce a firm to submit itself to a particular regime.[173] From this discussion, considering firms' *ex ante* incorporation choice, both debtors and

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170. *See* Clifford W. Smith & Jerold B. Warner, *On Financial Contracting*, 7 J. FIN. ECON. 117, 152-54 (1979).

171. *See* LOMBARDO, *supra* note 72, at 166 (discussing rational behavior by creditors who reward incorporation in a Member State that has good law).

172. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1444-45 (1989).

173. As described above in Part II.A.3, an adjusting lender could select a given corporate law by asking the borrower to set up a subsidiary in the desired legal system in which the loan is given, and the subsidiary would then enter into a nonreincorporation covenant, while the parent guarantees the loan. However, this will work only if the subsidiary is endowed with a sufficient amount of assets to repay the loan; otherwise, the lender will have to call upon the guarantee, in which case the corporate law governing the parent corporation will be of primary importance again.

lenders should have an incentive to lobby states to implement creditor-protection rules which are beneficial to lenders (and borrowers).

However, the analysis so far ignores nonadjusting and partially adjusting creditors. Most of all, tort claimants will not be able to adjust their claims. Small, less sophisticated creditors (e.g., suppliers) will be unable to determine exactly the risk involved and will find it too costly to draft an agreement precisely reflecting the risk of the borrower.[174] It is for these creditors that a boilerplate-contract corporate law will be insufficient. Hence, in the presence of nonadjusting creditors, a "race to the bottom" is theoretically possible, because those creditors will not adequately react to the choice of a suboptimal corporate law.[175]

An obvious objection is that nonadjusting creditors may free ride on the bargaining power of large lenders. Within certain limits, this is likely to happen, namely in those cases where the law of a specific jurisdiction is beneficial to creditors as a group. However, free riding will not work if the choice of law involves a conflict of interest between different groups of lenders, e.g., where bank loans are collateralized, while trade creditors do not possess such protection. Choice-of-law opportunities may therefore be detrimental to nonadjusting creditors (in particular, tort creditors) vis-à-vis adjusting creditors.[176]

3. *Ex Post* Reincorporation

So far, only newly founded companies have taken advantage of corporate law arbitrage within the EU. Once a specific regime has been chosen, firms are locked into a particular system of creditor protection. This is due mostly to the costs of moving: firms may need to resort to complicated constructions in order to switch to a new

174. *See generally* Bebchuk & Fried, *supra* note 15, at 857, 864-65; Horst Eidenmüller, *Beschränkungen der Niederlassungsfreiheit und ihre Rechtfertigung*, *in* AUSLÄNDISCHE KAPITALGESELLSCHAFTEN, *supra* note 64, § 3 cmts. 39-40, at 60.

175. *See* Bebchuk, *supra* note 2, at 1489-90.

176. *See* Gelter, *supra* note 81, at 276.

regime.[177] Furthermore, they face severe obstacles resulting from taxation.[178]

The first problem has been alleviated, at least to some degree, by the recently enacted Cross-Border Merger Directive and the ECJ's recent opinion in *In re SEVIC Systems AG*.[179] In SEVIC, the ECJ found that the German law's failure to allow for cross-border mergers violates articles 43 and 48 of the EU Treaty.[180] The second issue should have been partly resolved by Council Directive 90/434/EEC (Directive on the Taxation of Mergers), which prohibits the taxation of hidden reserves in cross-border mergers subject to certain conditions.[181] However, presently it remains unclear whether other types of reincorporation will be possible without resulting in deterrent tax consequences. Where reincorporation entails a change in the firm's tax residence, which will not necessarily be the case if no assets are relocated, it will often trigger exit taxation of unrealized gains. In *Lasteyrie du Saillant v. Ministère de L'Économie, des Finances et de l'Industrie*, the ECJ found that this was not permissible under the freedom of establishment when a natural person moved to another Member State.[182] There are good reasons to believe that this reasoning also applies when a corporation reincorporates or moves to another

177. Consider, e.g., the Daimler-Chrysler merger, involving a German and an American corporation. *See* Theodor Baums, *Corporate Contracting Around Defective Regulations: The Daimler-Chrysler Case*, 155 J. INSTITUTIONAL & THEORETICAL ECON. 119, 122-23 (1999).

178. *See, e.g.*, Case 81/87, The Queen v. H.M. Treasury (*Ex parte Daily Mail*), 1988 E.C.R. 5483.

179. *See* Case C-411/03, SEVIC Sys. AG, 2005 E.C.R. I-10805; Cross-Border Merger Directive, *supra* note 73.

180. *See SEVIC Sys. AG*, 2005 E.C.R. para. 31; *see also* Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, 1997 O.J. (C 340) 1 arts. 43, 48.

181. *See* Council Directive 90/434/EEC, Directive on the Taxation of Mergers, art. 4(1), 1990 O.J. (L 225) 1, 20 [hereinafter Directive on the Taxation of Mergers]. *But see* INT'L BUREAU OF FISCAL DOCUMENTATION, SURVEY ON THE SOCIETAS EUROPAEA 78 (2003), *available at* http://ec.europa.eu/taxation_customs/resources/documents/survey.pdf (reporting, on the basis of a questionnaire conducted in the then-fifteen Member States, that the Directive on the Taxation of Mergers "still needs (partial) implementation in several Member States"); Edward B. Rock, Taxes and Charter Competition 19-21 (2005) (unpublished manuscript, on file with authors) (describing the limited scope of tax exemptions under the Directive on the Taxation of Mergers). In the United States, reincorporation in another state is normally considered a reorganization not giving rise to taxation. I.R.C. § 368(a) (2000); *cf.* Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1802 (2002). On tax impediments in Europe, see Tröger, *supra* note 52, at 16-18.

182. *See* Case C-9/02, 2004 E.C.R. I-2409 para. 69.

Member State, although it remains to be seen where exactly the ECJ will draw the line.[183]

Midstream or *ex post* corporate law arbitrage (i.e., during the later life of the corporation) adds another dimension to the analysis. Once firms are no longer locked into a particular legal regime, it may be in the interest of both parties to commit *ex ante* to stay in a particular legal system to which creditors have adjusted. In this case, contractual creditors need to deal only with the law of one jurisdiction and should be able to adjust and penalize bad law with relative ease, assuming there are no information asymmetries about the content of the particular law. The possibility of implicitly altering the terms of the lending agreement by reincorporating compares to the U.S. debate on mandatory rules in corporate law, which focuses on the relation between shareholders and managers. The usual justification given for making some rules mandatory in the midstream stage is managerial opportunism.[184] Even if the charter terms were fair when the corporation first went public, the argument goes, management can push through charter amendments which are not necessarily in shareholders' interest because shareholders are rationally ignorant and subject to collective-action problems and because charter amendments need to be proposed by the board of directors in the United States.[185] This precludes charter amendments that will benefit shareholders but

183. *See, e.g.*, Jens Kleinert & Peter Probst, *Endgültiges Aus für steuerliche Wegzugsbeschränkungen bei natürlichen und juristischen Personen*, 57 DB 673, 674 (2004); Tröger, *supra* note 52, at 17. *Contra* Wolfgang Schön, *Playing Different Games? Regulatory Competition in Tax and Company Law Compared*, 42 COMMON MKT. L. REV. 331, 359-60 (2005) (highlighting the implications of broad sweeping a holding like the one in *Lasteyrie du Saillant* for corporations); Rock, *supra* note 181, at 21-25 (similarly doubting that, unless corporate income tax is federalized, Member States would accept that corporations can reincorporate without paying taxes on hidden reserves). *But see* Gilbert Parleani, *Relocation and Taxation: The European Court of Justice Disallows the French Rule of Direct Taxation of Unrealised Gains*, 1 EUR. COMPANY & FIN. L. REV. 379, 381 (2004) (waiting for a legislative solution). In particular, in the case of mere reincorporation without a relocation of assets, it seems hard to conceive how a taxation of reserves could be justified in light of the EC case law, as the ability to tax those reserves later will not be lost. *See* Andreas Engert, *Steuerrecht*, *in* AUSLÄNDISCHE KAPITALGESELLSCHAFTEN, *supra* note 64, § 8 cmt. 111 (arguing that German exit taxation should not apply in such cases in light of European law); Franz Wassermeyer, *Steuerliche Konsequenzen aus dem EuGH-Urteil "Hughes de Lasteyrie du Saillant*,*"* 95 GMBHR 613, 615-16 (2004) (same); *see also* Case C-446/03, Marks & Spencer plc v. Halsey, 2005 E.C.R. I-10837 paras. 27-59 (applying a test of proportionality to the question of whether a Member State may permit the offsetting of profits made by a subsidiary in the same State while prohibiting the offsetting of profits made elsewhere).

184. *See* Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1835-47 (1989).

185. *See id.*

be to the detriment of management.[186] Therefore, it may be beneficial if company managers' hands were tied with respect to charter amendments.[187]

Similarly, it may be beneficial if a firm is committed to the terms of a lending agreement, as implied by the corporate law regime of its state of incorporation. However, if the debtor is not committed to a particular system, or if such a commitment is impossible or prohibitively costly, the opportunity to move to a less creditor-friendly jurisdiction creates a new moral-hazard problem vis-à-vis creditors.[188] Under the regime created by recent ECJ case law, shareholders may unilaterally decide to change the firm's charter or to reincorporate in another jurisdiction without creditors' approval.[189] This moral-hazard opportunity raises information costs for creditors who need to deal with the laws of the multiple states in which a corporation might reincorporate.

With time, sophisticated creditors would probably learn how to deal with this and, at the very least, adjust interest rates accordingly. Conceivably, a lending contract or a bond covenant could require the debtor to stay within one particular legal system. In most cases, creditors theoretically will be in the position to protect themselves against this particular type of moral hazard. Even today, loan agreements with banks often stipulate the acceleration of the loan in the case of significant transactions, such as mergers. Similarly, contracts might penalize reincorporations by raising interest rates in

186. *See id.*

187. *See* Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1573-85 (1989).

188. *See* LOMBARDO, *supra* note 72, at 181-82.

189. To be sure, the ECJ's opinion in Case 81/87, *The Queen v. H.M. Treasury (Ex Parte Daily Mail)*, 1988 E.C.R. 5483, allows Member States to impose an export ban on the firms incorporated under their respective law, is frequently still considered good law. *See, e.g.*, Bayerisches Oberstes Landesgericht [BayObLG] [Court of Appeals for Selected Matters in Bavaria] Feb. 11, 2003, 2004 Entscheidungen des Bayerischen Obersten Landesgerichts in Zivilsachen [BayObLGZ] 24 (F.R.G.); Frank Woolridge, *Überseering: Freedom of Establishment of Companies Affirmed* 14 EUR. BUS. L. REV. 227, 231-32 (2003); Eva Micheler, Current Development, *Recognition of Companies Incorporated in Other EU Member States*, 52 INT'L & COMP. L.Q. 521, 524 (2003); *cf.* Wolf-Georg Ringe, *Anmerkung*, 58 DB 2806, 2807 (2005) (arguing that *Daily Mail* is still good law in light of the ECJ's *SEVIC* judgment, which dealt with an inbound case); Wulf-Henning Roth, *From* Centros *to* Ueberseering*: Free Movement of Companies, Private International Law, and Community Law*, 52 INT'L & COMP. L.Q. 177, 197 (2003) (stating that Member States will have to reconsider their position on moving out as well). However, following the *Lasteyrie du Saillant* opinion, there are good reasons to believe that this is no longer the case.

such a case. These clauses may be a sufficient deterrent in many cases, at least as long as bankruptcy is not imminent.

Even when a "commitment" clause is in place, it is shareholders who need to initiate a reincorporation, even though creditors need to approve it. The ensuing distribution of powers between shareholders and creditors is analogous to that between managers and shareholders in the United States.[190] One could argue that in the theoretical case where a move will increase the total value of the firm by improving the position of creditors, but will take away some value from shareholders, a reincorporation will not be implemented.[191]

As before, the crucial question is how well creditors are able to deal with the issue on their own, in particular by contracting for a commitment clause *ex ante*. Tort creditors are of course unable to adjust, although a reincorporation to escape tort claims will not be possible given that the private international law of torts typically follows the *lex loci commissi delicti*, meaning the law applied is the law of the country in which the tort was committed.[192] With respect to claims against the corporation, tort creditors will in most cases be primarily interested in postinsolvency rules. However, reincorporation may sometimes be a way to escape veil piercing.[193]

190. *Cf.* Bebchuk, *supra* note 2, at 1470 (explaining that due to managerial veto power over reincorporations, moves enhancing shareholder value will not ensue if they hurt managers).

191. Of course, if lending is concentrated and negotiations can take place between creditors and managers or controlling shareholders, leaving aside the possibility of bargaining breakdowns, such a reincorporation may take place. Typically, sophisticated adjusting creditors, such as the firm's main bank, will be able to stimulate the other groups to initiate a negotiation. However, the benefits of Coasian bargaining are limited as it will probably be used only to the benefit of adjusting creditors. On the other side of the bargaining table, it seems also likely that only large shareholders and managers, but not the minority, will be primary beneficiaries of the negotiations.

192. A theoretical case where corporate law could become relevant would be the implementation of unlimited shareholder liability for corporate torts in at least one country, as famously proposed by Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1880-81 (1991). Shareholders would have an incentive to reincorporate if the firm is facing a mass tort claim.

193. *See* Stefan Leible, *Rechts- und Geschäftsfähigkeit. Kaufmannseigenschaft*, *in* GRENZÜBERSCHREITENDE GESELLSCHAFTEN, *supra* note 98, § 10 cmt. 25 (stating that veil-piercing claims for undercapitalization or commingling of assets are qualified as corporate law by German courts and authors); Schall, *supra* note 9, at 1552 (suggesting that veil piercing is to be considered corporate law); *see also* Amtsgericht Bad Segeberg [AG Bad Segeberg] [Bad Segeberg District Court] Mar. 24, 2005, 17 C 289/04, 95 GMBHR 884 (2005) (F.R.G.) (rejecting a veil-piercing claim for undercapitalization against an English Ltd because English law does not require private companies to have any capital). However, this case was decided differently on appeal. *See* LG Kiel Apr. 20, 2006, 10 S 44/05, 61 BB 1314

Furthermore, typically commitment clauses or acceleration clauses will be stipulated only to the benefit of large adjusting creditors. Again, sophisticated creditors may cooperate with shareholders and managers to the detriment of less sophisticated ones, namely by agreeing to a reincorporation in a jurisdiction where, for example, tort creditors are treated badly but creditors whose claims are collateralized are treated well.

Of course, Member States or the EC itself may provide for creditor-protection tools in the event of a reincorporation provided, in the former case, that they satisfy the *Gebhard* criteria.[194] A reincorporation is now possible (or soon will be) either through a cross-border merger or through the creation of a European company, in both cases by merging the operating corporation into a wholly owned shell corporation created in the reincorporation State.[195] Irrespective of which of the two methods is selected, national rules providing "an adequate system of protection of the interests of creditors" pursuant to the Third Directive apply to such transactions.[196] Hence, one may argue that all creditors are protected against the risk of opportunistic reincorporations. However, as argued above,[197] while sophisticated creditors do not need such a system of protection, other creditors will normally be unable to take advantage of it, with the possible exception of tort creditors.[198]

(2006); *see also* BGH Mar. 14, 2005, II ZR 5/03, 60 BB 1016 (2005) (rejecting a claim against shareholders of an English company by analogy to the German rules about companies prior to registration); *cf.* Horst Eidenmüller, *Gesellschaftsrecht*, *in* AUSLÄNDISCHE KAPITALGESELLSCHAFTEN, *supra* note 64, § 4, at 85, cmts. 21-26, at 92-94 (arguing that the German doctrine of *Existenzvernichtungshaftung*—liability to creditors for endangering the corporation's existence—follows corporate law); Gerald Spindler & Olaf Berner, *Gläubigerschutz im Gesellschaftsrecht nach Inspire Art*, 50 RECHT DER WIRTSCHAFT: BETRIEBS-BERATER INTERNATIONAL 7, 11 (2004) (F.R.G.) (same).

194. *See* Case C-55/94, Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995 E.C.R. I-4165; *cf.* Schall, *supra* note 9, at 1553 (suggesting that even those German creditor-protection mechanisms cannot apply to U.K. companies under the freedom of establishment).

195. *See* Luca Enriques, *Silence Is Golden: The European Company as a Catalyst for Company Law Arbitrage*, 4 J. CORP. L. STUD. 77, 79-80 (2004).

196. Third Directive, *supra* note 131, art. 13; Cross-Border Merger Directive, *supra* note 73, art. 2, para. 2; Council Regulation 2157/2000, *supra* note 133, art. 24.

197. *See supra* Part III.A.3.

198. *But see* discussion *supra* note 137.

4. Conclusion

As we have seen, EC corporate law offers considerable leeway for regulatory arbitrage vis-à-vis creditors. On the positive side, regulatory competition is likely to remove mere slack, such as minimum capital, from which creditors derive no actual benefit. However, the outcome with respect to rules creditors actually may have an interest in depends on whether creditors are able to adjust to differences in the creditor-protection mechanisms of corporate law. For adjusting creditors, reincorporation and other types of moral hazards may be solved by covenants. This is not necessarily so for others, and certainly not for tort creditors. The position of large, sophisticated creditors who are able to adjust may actually be enhanced by regulatory arbitrage, to the detriment of nonadjusting groups of creditors.

Of course, the analysis of potential results of regulatory competition depends to a considerable degree on whether Member States actually have incentives to change their laws to *attract* (re)incorporations, as Delaware does. About this, we remain skeptical.[199] Admittedly, the fact that the U.K. Companies House accepts financial statements drawn up under non-U.K. law for purposes of the legal filing requirement may be taken as evidence that it is actively engaging in regulatory competition.[200] However, other actors such as legislators and courts have a more important role in shaping future law, and it remains to be seen whether they will actively seek to attract foreign incorporations.

IV. POSTINSOLVENCY RULES AND BANKRUPTCY FORUM SHOPPING

The increasing room for regulatory arbitrage in corporate law that follows, or will follow, EC negative and positive harmonization initiatives raises the issue of how corporate law and insolvency law interact in situations where the two bodies of law to be applied are from different Member States. There are in fact strong complements between the two.[201] If companies were free to choose the applicable corporate law and insolvency law, rules "could be selected that best fit

199. *See* Enriques, *supra* note 52, at 1266-73 (providing arguments for the implausibility of a Delaware-like scenario within the EU); Gelter, *supra* note 81, at 259-64 (same).
200. *See* Westhoff, *supra* note 159, § 17, at 493.
201. *See* Schön, *supra* note 183, at 353-54.

the needs of shareholders and managers but not necessarily those of creditors ('cherry-picking')."[202] This is also true, albeit to a lesser degree, if free choice is possible with regard to corporate law only; in this case, corporate decision makers may choose the corporate law that in the event of insolvency provides the best combination with the relevant insolvency law from the point of view of managers and shareholders. If reincorporation is an available option, the prospect of more favorable treatment in bankruptcy, irrelevant as it might have been at the incorporation stage, will become the main driver of reincorporation decisions for companies on the brink of insolvency.

This Part inquires into the interactions between corporate and insolvency law within the EU, providing an introduction to the most relevant conflict-of-law rules. We subsequently reflect upon the implications of bankruptcy forum shopping in Europe.

A. *Postinsolvency Rules*

In order to analyze the interactions between corporate law and bankruptcy law in the post-*Centros* world, we first sketch out the private international law framework for insolvencies within the EU. The central piece of legislation in this area is now the EIR,[203] but attention will be given more specifically to two legal tools for creditor protection particularly relevant for our analysis: fraudulent conveyance laws and equitable subordination. The former can act as a substitute for the legal-capital doctrine where, like in the United States, such doctrine has been vestigialized.[204] Hence, to the extent that legal capital becomes less central in the EU as well, this tool may come to the foreground. The latter provides a good example of a corporate law doctrine that Member States may relatively easily relabel as an insolvency law tool.

1. Harmonization of Conflict-of-Law Rules in Insolvency Law: The European Insolvency Regulation in a Nutshell

In sharp contrast to the U.S. experience, where bankruptcy law is federal, insolvency law is still a matter of national law within the EU: no relevant substantive harmonization of EU insolvency rules has ever

202. Eidenmüller, *supra* note 13, at 435.
203. EIR, *supra* note 10.
204. *See generally* Enriques & Macey, *supra* note 14, at 1185-95.

been adopted (nor attempted) at the EC level.[205] However, in 2000, the EIR was passed in order to enhance cooperation among jurisdictions in insolvency proceedings by harmonizing conflict-of-law issues relating to insolvencies.[206]

The EIR identifies the Member States having jurisdiction to open insolvency proceedings by introducing a distinction between main proceedings, which have a universal effect (at least within the EU), and secondary proceedings, which can be opened if the debtor has an establishment and if the effects of the proceedings extend to assets situated in the territory of the establishment's Member State.[207] The EIR identifies the law applicable to insolvency proceedings as the law of the State of the court opening the proceedings, with a number of exceptions.[208] It also introduces the principle of mutual recognition of insolvency proceedings and provides rules for the coordination of main and secondary proceedings.[209] Finally, the EIR contains rules on information for creditors and on lodgment of their claims.[210] What is relevant here are the rules determining the competent court and, hence, the applicable insolvency law and its scope.

In general it can be said, at least it was the drafters' intention, that the EIR displays a strong disfavor for regulatory competition in insolvency law. As the preamble to the EIR puts it: "It is necessary for the proper functioning of the internal market to avoid incentives for the parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position (forum shopping)."[211] As we shall see, the regulatory framework is only partly consistent with such an objective. However, it is apparent that if doubt arises in the interpretation of the EIR, the preamble provides an important guideline against any interpretation favoring parties' free choice of the insolvency regime.

The core provisions in the EIR are articles 3 and 4 on international jurisdiction and applicable law, respectively. According

205. For an account of the few substantive harmonization measures in the insolvency law field, see MIGUEL VIRGÓS & FRANCISCO GARCIMARTÍN, THE EUROPEAN INSOLVENCY REGULATION: LAW AND PRACTICE 9 (2004).

206. *See* EIR, *supra* note 10.

207. *See id.* art. 3. Article 2(h) defines an establishment as "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods." On this notion, see, e.g., VIRGÓS & GARCIMARTÍN, *supra* note 205, at 158-62.

208. *See* EIR, *supra* note 10, arts. 4-15.

209. *Id.* arts. 16-38.

210. *Id.* arts. 39-42.

211. *Id.* pmbl., para. 4.

to article 3, jurisdiction for main proceedings is identified according to the COMI criterion, while secondary proceedings can be opened where the debtor has an establishment.[212] Under article 4, "the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened" (*lex fori concursus*).[213] The EIR further provides a nonexhaustive list of matters included in the *lex fori concursus*, ranging from "the conditions for the opening of th[e] proceedings" to "the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors."[214] However, it contains a number of exceptions to the *lex fori concursus*, such as those concerning third parties' rights in rem and contracts of employment, including an important qualification with regard to detrimental acts.[215]

Despite COMI's key role in determining jurisdiction and in solving conflict-of-law issues in insolvency, there is surprisingly no definition of COMI in the text of the EIR. Instead, there is a rebuttable presumption that for companies and legal persons, "the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary."[216] The rationale for this presumption is that a corporation's head office is usually situated where the corporation has its registered office.[217] This presumption is by no means evidence of the lawmakers' willingness to favor debtor's choice in insolvency matters.[218]

A definition of COMI can, however, be found in the preamble to the EIR, where it states: "The [COMI] should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties."[219] Legal scholars and courts across the EU agree that what counts is where the

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212. *Id.* art. 3, paras. 1-2.

213. *Id.* art. 4, para. 1.

214. *Id.* art. 4, paras. 2, 2(m). On the rules relating to the voidness, voidability, or unenforceability of legal acts, see *infra* Part IV.B.

215. *EIR supra* note 10, arts. 5-15; *see infra* Part IV.B.

216. *EIR supra* note 10, art. 3, para. 1.

217. *See, e.g.*, VIRGÓS & GARCIMARTÍN, *supra* note 205, at 44; Miguel Virgos & Etienne Schmit, *Report on the Convention on Insolvency Proceedings*, *in* THE EC REGULATION ON INSOLVENCY PROCEEDINGS: A COMMENTARY AND ANNOTATED GUIDE 263, para. 75, at 281-82 (Gabriel Moss et al. eds., 2002) [hereinafter EIR COMMENTARY].

218. *But see* Armour, *supra* note 9, at 407-08 (arguing that the presumption created by EIR article 3(1) should be "a strong one").

219. EIR, *supra* note 10, pmbl., para. 13. According to Virgós and Garcimartín, for various reasons this definition has "the same value as the definitions contained in Article 2." VIRGÓS & GARCIMARTÍN, *supra* note 205, at 39-40.

"head office functions are carried out" on a regular basis, rather than where the head office is located.[220]

A thorough investigation into the meaning of COMI is unnecessary here. Suffice it to say, despite the emphasis in the preamble and in commentaries on the EIR on the fact that "transparency and objective ascertainability are dominant factors" in determining COMI,[221] it is unquestionable that COMI is a highly ambiguous and manipulative concept that requires subjective and fact-intensive evaluation by judges.[222] As a consequence, not only insolvent companies with international operations, but also their creditors, are able to some degree to select the forum (and hence the law) of their choice. This is especially true with regard to subsidiaries within a group of companies. As a number of precedents already show, it is both easy for the court where the subsidiary has its administration (and registered seat) and for the court where the parent has its COMI to claim jurisdiction over the subsidiary's insolvency.[223]

Because it is the filing time that determines COMI, debtors may shop for friendlier insolvency laws also by switching COMI when

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220. *In re* Daisytek-ISA Ltd., [2003] B.C.C. 562 (Ch.) (Eng.); MG Rover Ir. Ltd, [2005] EWHC 874 (Ch.) (Eng.); Tribunale di Roma [Trib. di Roma] [Ordinary Court of First Instance], 26 nov. 2003, 2004 RIVISTA DI DIRITTO INTERNAZIONALE PRIVATO E PROCESSUALE 691 (*Cirio Holding Luxembourg S.A.*); Case C-341/04, Eurofood IFSC Ltd, 2006 E.C.R. I-3813, paras. 26-37.

221. Ian F. Fletcher, *Scope and Jurisdiction, in* EIR COMMENTARY, *supra* note 217, at 35, 39; *cf.* AG München May 4, 2004, 1501 IE 1276/04, 25 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT UND INSOLVENZPRAXIS [ZIP] 962 (2004) (F.R.G.).

222. *See MG Rover Ir. Ltd*, [2005] EWHC 874 (citing an unreported opinion by Judge Langan where a decision based on COMI is called "a fact sensitive" one); Eidenmüller, *supra* note 13, at 428 (highlighting "the fuzziness of the COMI standard"); Sefa M. Franken, *Three Principles of Transnational Corporate Bankruptcy Law: A Review*, 11 EUR. L.J. 232, 249-53 (2005) ("[COMI] is a highly manipulative concept, especially by debtors" that leaves "ample discretion for creative judicial interpretation."); Bob Wessels, *The European Union Insolvency Regulation: An Overview with Trans-Atlantic Elaborations*, 2003 NORTON ANN. SURV. BANKR. L. 481, 503 (highlighting that decisions on COMI are "fact intensive"); Marc-Philippe Weller, *Inländische Gläubigerinteressen bei internationalen Konzerninsolvenzen*, 169 ZEITSCHRIFT FÜR HANDELS- UND WIRTSCHAFTSRECHT [ZHR] 570, 578-83 (2005) (giving an overview of the variety of locations courts have considered the COMI of an insolvent corporation); Federico Maria Mucciarelli, Note, *The Transfer of the Registered Office and Forum-Shopping in International Insolvency Cases: An Important Decision from Italy*, 2 EUR. COMPANY & FIN. L. REV. 512, 525 (2005) (same).

223. For a survey of the relevant cases, see Bob Wessels, *International Jurisdiction To Open Insolvency Proceedings in Europe, in Particular Against (Groups of) Companies* 16-23 (2003), http://www.iiiglobal.org/country/european_union/InternJurisdictionCompanies.pdf. *See also* Franken, *supra* note 222, at 250-53.

insolvency is near.[224] Of course, the switch of COMI immediately prior to the filing will not pass the test of continuity that is implied in the phrase "on a regular basis."[225] However, for switches taking place with some anticipation, it might be difficult not to recognize the new COMI, provided that the longer the time lag between the switch and the filing, the more difficult to resort to general abuse or fraud exceptions to disregard it.[226]

Incentives for forum shopping also derive from the EIR's solution to the problem of conflicting decisions on the opening of main proceedings. Based on the idea of mutual trust between EU courts, the criterion is purely temporal. Once a main proceeding has been opened by a court, other courts have to defer to that decision,[227] only limited by the public policy exception.[228] As courts have a tendency to recognize their own jurisdiction over insolvency proceedings, if only to protect local creditors' interests,[229] this temporal criterion implies that debtors and creditors may engage in a race to file in order to place the case

224. Incidentally, this creates an internal inconsistency in the EIR. If it is true that the perspective determining where the COMI is located should be that of *potential* creditors, then by identifying COMI with respect to potential creditors' hypothetical determinations at the time of filing, in the case of a switch of COMI, the court will necessarily have to disregard any prior determination about COMI by creditors predating the switch. *See* VIRGÓS & GARCIMARTÍN, *supra* note 205, at 42. Of course, one may reason that existing creditors who failed to contract for a covenant preventing switches of COMI accepted the risk of such a switch and, hence, can be disregarded in determining COMI. This sounds like a fairly groundless assumption with regard to unsophisticated creditors, however.

225. *See* VIRGÓS & GARCIMARTÍN, *supra* note 205, at 41, 50; *see also* Case C-1/04, Staubitz-Schreiber, 2006 E.C.R. I-701 (finding that the Member State where a request to open insolvency proceedings is filed retains jurisdiction even if the debtor moves its COMI to another Member State subsequently).

226. *Cf.* VIRGÓS & GARCIMARTÍN, *supra* note 205, at 41; Massimo V. Benedettelli, *"Centro degli interessi principali" del debitore e forum shopping nella disciplina comunitaria delle procedure di insolvenza transfrontaliera*, 40 RIVISTA DI DIRITTO INTERNAZIONALE PRIVATO E PROCESSUALE 499, 529 (2004).

227. *See* Wessels, *supra* note 222, at 503 n.39.

228. EIR, *supra* note 10, art. 26; *see also In re* Eurofood IFSC Ltd, [2005] B.C.C. 999 (Ir.) (deferring to the ECJ the question of whether Irish courts may refuse recognition of a Parma court's decision made after failure to grant the temporary administrator of an Irish company the right to a fair hearing before it).

229. *See* Frederick Tung, *Is International Bankruptcy Possible?*, 23 MICH. J. INT'L L. 31, 82-83 (2001); Weller, *supra* note 222, at 581 (referring to the Member State court's conduct as far as "mutual 'insolvency imperialism'" ["wechselseitiger 'Insolvenz-imperialismus'"]); *see also* Lynn M. LoPucki, *Universalism Unravels*, 79 AM. BANKR. L.J. 143, 149-52 (2005) (noting that in the EU, courts tend to claim jurisdiction even when they clearly do not have it). *But see* Trib. di Rimini, 6 apr. 2004, 2005 GIURISPRUDENZA ITALIANA 1199 (*In re Giacomellí Sport Groups s.p.a. in amministrazione straordinaria—Giacomellí Sport España S.A.*) (denying jurisdiction over a Spanish subsidiary of a failed Italian corporation).

before a given (and supposedly friendlier) court and, hence, to obtain the most convenient applicable law.[230]

To the extent that the EIR leaves some room for regulatory arbitrage in insolvency law, it is worth dealing briefly with the scope of the *lex fori concursus* as a useful introduction to the discussion in Part IV.B on whether "relabeling" corporate law rules as insolvency law rules can be a viable strategy for Member States. Without going into the details of the matters mentioned in article 4 and of the carve-outs in articles 5 through 15, it is again in the preamble that we find a general criterion to determine what issues are covered by the *lex fori concursus*.[231] Paragraph 6 of the preamble provides: "In accordance with the principle of proportionality this [r]egulation should be confined to provisions governing jurisdiction for opening insolvency proceedings and *judgments which are delivered directly on the basis of the insolvency proceedings and are closely connected with such proceedings*."[232] This criterion is clearly reminiscent of ECJ case law regarding Council Regulation 44/2001 (Brussels Regulation) on civil jurisdiction and, more precisely, on the scope of article 1(2)(b), which declares the Brussels Regulation inapplicable to bankruptcy.[233] The case law had in fact clarified that this provision extends to all actions deriving directly from the bankruptcy proceeding; i.e., whose outcome depends upon insolvency law, *and* closely connected to it, from a procedural point of view.[234] In *Gourdain v. Nadler*, the ECJ concluded that the French *action en comblement du passif* is part of bankruptcy law after conducting an independent characterization of the relevant French provisions and giving, of course, no weight to the "label" of the relevant provisions, i.e., whether they were located in French insolvency statutes or elsewhere.[235] The Court gave weight instead to the following: (1) the only competent court was the insolvency court; (2) only the liquidator could bring suit; (3) the rules on the burden of

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230. A race to file is facilitated by the ECJ's opinion in the *Eurofood* case. The ECJ affirmed that once any Member State has opened insolvency proceedings, the other States do not have the power to review the decision. Case C-341/04, Eurofood IFSC Ltd, 2006 E.C.R. I-03813, paras. 111-112; *see* Thomas Bachner, *The Battle over Jurisdiction in European Insolvency Law*, 3 EUR. COMPANY & FIN. L. REV. 310, 316-19, 325-27 (2006) (criticizing the ECJ's reference to mutual trust).

231. *See* EIR, *supra* note 10.

232. *Id.* pmbl., para. 6 (emphasis added).

233. Council Regulation 44/2001, 2001 O.J. (L 12) 1 (EC).

234. *See* VIRGÓS & GARCIMARTÍN, *supra* note 205, at 61.

235. Case 133/78, 1979 E.C.R. 733, 743. The legal basis for this type of lawsuit is C. COM. art. L624-3 (Fr.).

proof derogated from the general ones under the law of liability; (4) the statute of limitations was linked to a certain stage of the insolvency proceeding; (5) if the action succeeded, it would be the general body of creditors that would benefit; and (6) managers could be declared insolvent in case they did not discharge their liabilities toward the creditors without inquiring into whether the relevant requisites for their declaration of insolvency existed.[236]

2. Fraudulent Conveyance

All EU jurisdictions have rules against fraudulent conveyance (or fraudulent transfers) and preferences for certain creditors, permitting recovery of funds from the recipients of such conveyances.[237]

Similarly, most states in the United States enacted either the older Uniform Fraudulent Conveyances Act or the newer Uniform Fraudulent Transfers Act,[238] and the federal Bankruptcy Code includes an equivalent statute on transfers[239] and another one on preferences.[240] Those statutes cover transactions in which the debtor did not receive "reasonably equivalent value in exchange for the transfer" and "for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction."[241] The provision is interpreted widely to include also dividends and share repurchases.[242] Because the applicable fraudulent-transfer law does not depend on the state of incorporation, corporations are not subject to regulatory competition (between different corporate law regimes) in the United States.[243] In

236. *Gourdain*, 1979 E.C.R. at 744.

237. *See* VIRGÓS & GARCIMARTÍN, *supra* note 205, at 134.

238. ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES, AND PROBLEMS 81 (5th ed. 2006).

239. 11 U.S.C. § 548 (2000).

240. *Id.* § 547.

241. UNIF. FRAUDULENT TRANSFER ACT § 4(a)(2), 7A U.L.A. 301 (1999).

242. CLARK, *supra* note 166, at 88–90 (discussing dividends); Andreas Engert, *Life Without Legal Capital: Lessons from American Law*, *in* LEGAL CAPITAL IN EUROPE, *supra* note 110, at 646, 669-80; Marcel Kahan, *Legal Capital Rules and the Structure of Corporate Law: Some Observations on the Differences Between European and U.S. Approaches*, *in* CAPITAL MARKETS AND COMPANY LAW 145, 146 (Klaus J. Hopt & Eddy Wymmeersch eds., 2003) (discussing both dividends and share repurchases); *see also* APAC-Va., Inc. v. Jenkins Landscaping & Excavating, Inc. (*In re* Jenkins Landscaping & Excavating, Inc.), 93 B.R. 84, 88 (W.D. Va. 1988); United States v. Gleneagles Inv. Co., 565 F. Supp. 556, 583-85 (M.D. Pa. 1983); Wells Fargo Bank v. Desert View Bldg. Supplies, Inc. (*In re* Desert View Bldg. Supplies, Inc.), 475 F. Supp. 693, 695-96 (D. Nev. 1978); Mancuso v. Champion (*In re* Dondi Fin. Corp.), 119 B.R. 106, 113 (Bankr. N.D. Tex. 1990).

243. *See* Gelter, *supra* note 81, at 281; Kahan, *supra* note 242, at 148.

theory, fraudulent-transfer laws could take the function of provisions on legal capital-limiting dividends in Europe and of the concealed-distribution doctrines used in some countries.[244]

The EIR does not apply to statutes on conveyances and preferences outside bankruptcy. In that context, the only restraint on Member States is primary EC law.[245] However, any rule of this kind is superseded by the EIR once the corporation enters into bankruptcy, meaning that any conflict-of-law rules applied by Member States outside bankruptcy will be of very limited significance. Under the EIR, as a general rule, the law of the state opening insolvency proceedings determines "the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors."[246] The EIR, however, also provides for an important exception to this rule, which may even allow for some "separate" forum shopping concerning preferences. The general rule does not in fact apply when the person benefiting from the act proves: (1) the "act is subject to the law of a Member State other than that of the State of the opening of proceedings," and (2) "that law does not allow any means of

244. *Cf.* Mellon Bank, N.A. v. Metro Commc'ns, Inc., 945 F.2d 635, 647 (3d Cir. 1991) (discussing the reasonable equivalent-value requirement in the context of a leveraged buyout).

245. For example, the respective German statute states that a legal act will be evaluated under the law applying to its effects (*Wirkungsstatut* or *lex causae*). ANFG § 19. Apparently, the majority opinion in Germany interprets this as the law governing the contract or, in the more important case where a creditor seeks to rescind a transfer of title, the *lex rei sitae* (i.e., the location of the property in question). *See* Ulrich Huber, *Das für die anfechtbare Rechtshandlung maßgebende Recht*, *in* FESTSCHRIFT FÜR ANDREAS HELDRICH 695, 701 (Stephan Lorenz et al. eds., 2005) (summarizing and criticizing the prevailing opinion). Similarly, Austrian courts have subjected conveyances to Austrian law if the property in question was located in Austria. Oberster Gerichtshof [OGH] [Supreme Court] May 23, 1984, 3 Ob 507/84, 27 ZEITSCHRIFT FÜR RECHTSVERGLEICHUNG 290 (1986) (Austria). *But see* OGH Apr. 27, 2006, 2 Ob 196/04v, 129 JURISTISCHE BLÄTTER [JBl] 61 (2007) (holding that the most important factor in determining the applicable law is in which country the reduction of funds available for creditors took place). For Italy, compare Corte di cassazione [Cass.] [Court of Last Appeal in Civil and Criminal Matters], sez. un., 7 may 2003, n.6899, 2004 RIVISTA DI DIRITTO INTERNAZIONALE PRIVATO E PROCESSUALE 635, 640-44 (finding that Italian judges have jurisdiction on a fraudulent-conveyance action on the basis of *lex contractus*). For France, see YVON LOUSSOUARN ET AL., DROIT INTERNATIONAL PRIVÉ 514 (8th ed. 2004) (concurring in the scholarly opinion that *lex contractus* applies to *actio pauliana*).

246. EIR, *supra* note 10, art. 4, para. 2(m). The German and French versions of the text lend themselves to the conclusion that it need not be shown that each individual creditor was harmed, but that the language actually means the general body of creditors. Gabriel Moss & Tom Smith, *Commentary on Council Regulation 1346/2000 on Insolvency Proceedings*, *in* EIR COMMENTARY, *supra* note 217, at 155, para. 8.80, at 180.

challenging that act in the relevant case."[247] As a result, the more lenient of the two provisions always applies if the beneficiary satisfies the burden of proof.[248] The crucial question is, of course, which country's law applies to the relevant act. The literature generally seems to imply that the law applicable to the transaction under the conventional rules of the private international law of contract apply.[249] This may allow the parties entering into a contract to choose a relatively lenient fraudulent-transfers regime independently from where insolvency proceedings are carried out, most obviously by a choice-of-law clause.[250]

In light of this, conveyances will take part in "general" forum shopping and in regulatory competition for insolvency law, if there is any. To conclude, article 13 leaves open some limited room for forum shopping independent of bankruptcy.

3. Subordination

Several European jurisdictions have statutes or doctrines under which loans given by shareholders to the corporation under certain circumstances are subordinated to other debt in bankruptcy.[251] The economic rationale for such doctrines is that risk enhancement resulting from the continued operation of the firm is detrimental to third-party creditors because the proceeds available in liquidation will typically be lower if the firm continues to operate because of the loan.[252] On the other side, shareholders will capture most of the

247. EIR, *supra* note 10, art. 13; *see* Insolvenzordnung [InsO], Oct. 5, 1994, BGBl. I at 2866, as amended, Gesetz, Nov. 10, 2006, BGBl. I at 2553, art. 12, § 339 (F.R.G.) (similar text to the EIR applying the same criteria to cross-border insolvencies with non-EU countries).

248. *See* Sebastian Zeeck, *Die Anknüpfung der Insolvenzanfechtung*, 2005 ZEITSCHRIFT FÜR DAS GESAMTE INSOLVENZRECHT [ZInsO] 281, 287 (F.R.G.).

249. *See* Henriette-C. Duursma-Kepplinger, *Artikel 13*, *in* EUROPÄISCHE INSOLVENZVERORDNUNG: KOMMENTAR 318, para. 16, at 324 (Henriette-C. Duursma-Kepplinger et al. eds., 2002); Stuart Isaacs et al., *The Effect of the Regulation on Cross-Border Security and Quasi-Security*, *in* EIR COMMENTARY, *supra* note 217, at 91, cmt. 6.132, at 128; Zeeck, *supra* note 248, at 286.

250. Isaacs et al., *supra* note 249, cmt. 6.127, at 127. To be sure, at least in some cases, courts might consider this kind of transaction planning fraudulent or abusive. *See* Duursma-Kepplinger, *supra* note 249, cmt. 16, at 324; Huber, *supra* note 245, at 711.

251. *See infra* notes 254-261 and accompanying text.

252. *See generally* Martin Gelter, *The Subordination of Shareholder Loans in Bankruptcy*, 27 INT'L REV. L. & ECON. (forthcoming 2007) (manuscript available at http://ssrn.com/abstract=654222) (showing differences between the efficiency objective and the incentive effects of subordination).

benefits of continued operations because a successful turnaround of the business will result in increased shareholder wealth, while the gains creditors can make are typically only minute.[253]

The best known example is the German *Kapitalersatzrecht*, which covers not only loans given in times of crisis (not necessarily insolvency, but under circumstances where only shareholders would have extended a loan), but also loans not withdrawn at the onset of a crisis.[254] Similar doctrines exist in Austria,[255] Italy,[256] Slovenia,[257] and other countries.[258] Similarly, U.S. courts developed the doctrines of *equitable subordination*,[259] which found statutory recognition in § 510(c) of the Bankruptcy Code of 1978,[260] and the more recent *recharacterization* doctrine.[261] Other than the German doctrine, which

253. *See generally id.*; Andreas Engert, *Die ökonomische Begründung der Grundsätze ordnungsgemäßer Unternehmensfinanzierung*, 33 ZGR 813 (2004).

254. *Kapitalersatzrecht* was originally developed by the courts. *See, e.g.*, Reichsgericht [RG] [Federal Court of Justice] Oct. 22, 1938, 158 Entscheidungen des Reichsgerichts in Zivilsachen [RGZ] 302 (F.R.G.); RG Jan. 13, 1941, 166 RGZ 51; BGH Dec. 14, 1959, 31 BGHZ 258. The doctrine was codified in 1980, but the courts continued to apply the principles they had developed in parallel with the statutory rules. GmbHG, Apr. 20, 1892, RGBl. at 477, as amended, Gesetz, Mar. 22, 2005, BGBl. I at 837, art. 12, §§ 32(a)-(b); *see* BGH Mar. 26, 1984, 90 BGHZ 370. For a historical overview, see GERHARD SCHUMMER, DAS EIGENKAPITALERSATZRECHT: NOTWENDIGES RECHTSINSTITUT ODER IRRWEG? 7-81 (1998); Hans-Georg Koppensteiner, *Kritik des "Eigenkapitalersatzrechts*," 43 AG 308, 308-09 (1998).

255. Gesellschafts- und Insolvenzrechtsänderungsgesetz 2003 [GIRÄG 2003], BGBl. I No. 92/2003, art. 1 (Austria). Article 1 is known as the *Bundesgesetz über Eigenkapital ersetzende Gesellschafterleistungen* [*Eigenkapitalersatz-Gesetz-EKEG*].

256. *See* Cass. Civ., sez. un., 3 dec. 1980, n.6315, Giur. It. 1981, II, 895; Trib. Milano, 5 dec. 1988, 88 RIVISTA DI DIRITTO COMMERCIALE II/75 (1990); Trib. Treviso, 18 dec. 2001, 55 BANCA, BORSA, TITOLI DI CREDITO II/723 (2002); Trib. Milano, 28 june 2001, 55 BANCA, BORSA, TITOLI DI CREDITO 723 (2002); *see also* Cass. Civ. sez. un., 19 mar. 1996, n.2314, 1996 SOCIETÀ 1267; C.C. arts. 2467, 2497—*quinquies* (as introduced by Legislative Decree No. 6 of Jan. 17, 2003, Gazz. Uff. Jan. 22, 2003, No. 17, Supplemento Ordinario). For an overview, see Giovanni Tantini, *I versamenti dei soci alla società*, *in* 1*** TRATTATO DELLE SOCIETÀ PER AZIONI, *supra* note 55, at 743, 795-800 (2004).

257. Zakon o gospodarskih družbah [ZGD-1] [Companies Act] št. 42/2006 Uradni list Republike Slovenije [Ur.l. RS] §§ 433-434 (Slovn.); *see* Markus Bruckmüller, *Eigenkapitalersatz in Slowenien*, *in* EIGENKAPITALERSATZ IM ÖSTERREICHISCHEN, ITALIENISCHEN UND SLOWENISCHEN RECHT 69 (Susanne Kalss & Friedrich Rüffler eds., 2004).

258. *See, e.g.*, Pietro Abbadessa, *Il problema dei prestiti dei soci nelle società di capitali: una proposta di soluzione*, 15 GIURISPRUDENZA COMMERCIALE I/497, I/503 (1988) (discussing Belgian and Portuguese law).

259. *See* Taylor v. Standard Gas & Elec. Co., 306 U.S. 307, 322 (1939); Pepper v. Litton, 308 U.S. 295, 307-09 (1939).

260. 11 U.S.C. § 510(c) (2000).

261. *See, e.g.*, Bayer Corp. v. MascoTech, Inc. (*In re* Autostyle Plastics, Inc.), 269 F.3d 726, 748-50 (6th Cir. 2001); Fett v. Moore (*In re* Fett Roofing & Sheet Metal Co.), 438 F. Supp. 726, 729-30 (E.D. Va. 1977); *In re* Cold Harbor Assocs., 204 B.R. 904, 915 (Bankr.

prohibits repayments while the corporation remains uncreditworthy, the American doctrines apply only in bankruptcy. However, the crucial point for issues of regulatory competition is that the equitable-subordination doctrine, as part of the bankruptcy code, does not share in regulatory competition for corporate law.

B. Forum Shopping for Insolvency Law

It is sometimes suggested that EU bankruptcy law as it implements a uniform system of conflict-of-law rules is not quite unlike the real-seat theory. The EIR, at first glance, seems to imply that a specific COMI can be determined for each individual firm. However, the practical experience with the EIR during its first years lends itself to a partly different conclusion. For firms active in one country only, COMI is unambiguous, leaving no option for forum shopping as far as different insolvency law regimes are concerned. By contrast, firms with operations in different countries, and above all international groups, have leeway to engineer insolvency proceedings in one of the countries in question. The substantive rules of bankruptcy are not a matter of federal law in Europe like they are in the United States, and therefore one might speculate whether the result will not be mere forum shopping, but actual regulatory competition, which implies states adapting their law to attract insolvency filings.

There is little doubt that forum shopping has potential benefits. In the United States, even though bankruptcy law is federal law, courts have some discretion in the application of procedural and substantive rules. Proponents argue that forum shopping has enabled bankrupt firms to choose venues where judges are predictable, fast, and competent in handling the reorganization of large firms.[262] In other words, incumbent managers may have been able to choose the forum maximizing the total value of the reorganized firm (typically the New York and Delaware courts).[263] *Ex post* value maximization may, in some cases, harm creditors to the benefit of other interest groups (such as shareholders and employees benefiting from continued operation), which is efficient if the benefits to those groups exceed the harm to creditors. Potential harm to creditors because of the evasion of

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E.D. Va. 1997); *see also* David A. Skeel, Jr. & Georg Krause-Vilmar, *Recharacterization and the Nonhindrance of Creditors*, 7 EUR. BUS. ORG. L. REV. 259 (2006).

262. *See* Cole, *supra* note 5, at 1859-76; Ayotte & Skeel, *supra* note 5, at 15-17.

263. *See* Cole, *supra* note 5, at 1859-76; Ayotte & Skeel, *supra* note 5, at 15-17.

creditor-protection mechanisms therefore needs to be weighed against the benefits of *ex post* maximization.

Likewise, gains from regulatory arbitrage can be made by shopping between different European bankruptcy regimes.[264] The possibility of secondary insolvency proceedings concerning the debtor's assets in another State mitigates these gains, but does not eliminate them. In some cases, secondary procedures will not be an option. First, the debtor needs to have an establishment in the country where secondary proceedings are to take place.[265] Second, proceedings will typically not be opened where the very limited assets in the relevant State are unlikely to cover costs.[266] Third, secondary proceedings will always result in the liquidation of assets, meaning that it will matter a lot to creditors in which country a reorganization procedure is initiated.[267] Furthermore, the law of the Member State will typically apply to certain procedures relating to insolvency, such as the claims against directors.[268] The particular powers of the liquidator of the main proceedings and the obligation to transfer any remaining assets to him may also make a difference.[269] Finally, as a practical matter, the race to file is a reality, as *Eurofood IFSC Ltd.*[270] illustrates.[271]

In the subsequent analysis, we look exclusively at the possibility of harm to creditors resulting from forum shopping. We first describe the commitment problem resulting from COMI and then point out some important differences from forum shopping for bankruptcy law in the United States. We analyze who may act as "case placers," and

264. *See* Horst Eidenmüller, *Wettbewerb der Insolvenzrechte?*, 35 ZGR 467, 477 (2006) (pointing out that insolvency proceedings are completed significantly faster in the United Kingdom than in France or Germany and that a much higher percentage of bank claims are satisfied, creating an incentive for banks to seek a forum in the United Kingdom). This data originally came from Sergei A. Davydenko & Julian R. Franks, *Do Bankruptcy Codes Matter?: A Study of Defaults in France, Germany and the UK* (European Corp. Governance Inst., Finance Working Paper No. 89/2005), *available at* http://ssrn.com/abstract=647861.

265. EIR, *supra* note 10, art. 3, para. 2.

266. *See, e.g.*, InsO. Oct. 8, 1994, BGBl. I at 2866, as amended, Gesetz, Nov. 10, 2006, BGBl. I at 2553, § 26 (F.R.G.).

267. EIR, *supra* note 10, art. 27 (referring to annex B of the EIR).

268. *See* Marc-Philippe Weller, *Forum Shopping im Internationalen Insolvenzrecht?*, 24 PRAXIS DES INTERNATIONALEN PRIVAT- UND VERFAHRENSRECHTS 412, 415 (2004); *see also infra* notes 297-300 and accompanying text.

269. *See* EIR, *supra* note 10, arts. 29, 33, 35.

270. Case C-341/04, 2006 E.C.R. I-3813.

271. *See infra* note 281 and accompanying text.

what consequences this may entail. Finally, we speculate whether States will have any incentive to attract insolvencies.

1. Basic Structure

There are, of course, a number of notable differences between insolvency and corporate law arbitrage. To begin with, the decision about the applicable legal regime is not made at the stage of incorporation, but rather when insolvency proceedings are to be initiated. This compares to the situation described in Part III.B with the crucial difference that the borrower is unable to commit to a particular legal system. In fact, other than by avoiding transnational activity that may result in an unexpected COMI altogether, firms cannot commit to insolvency proceedings in a particular jurisdiction to their creditors. The possibility of *ex post* forum shopping obviously reduces *ex ante* predictability for creditors and therefore increases the agency cost of debt.[272] However, only a limited number of jurisdictions will be an available option; even though an outsider may not be able to determine the COMI *ex ante* and managers have some opportunity to manipulate it, sophisticated creditors may be able to narrow down the available options.[273] To be sure, predictability may not be perfect, as the approach taken by English courts with regard to the COMI highlights: their COMI decisions have been criticized as being hard to predict by outsiders.[274]

Second, the choice-of-law decision is not necessarily taken by the insolvent corporation. A striking difference from the United States, where involuntary bankruptcies are rare, lies in the persons who petition for bankruptcy proceedings—the case placers.[275] Bankruptcy systems can be characterized as either manager-driven or manager-

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272. *See* Franken, *supra* note 222, at 236.

273. *See* Eidenmüller, *supra* note 13, at 427-28.

274. *See* Franken, *supra* note 222, at 248-54. This lack of predictability is the reason why several authors have suggested that *ex ante* free choice should be adopted; this would both allow firms to choose the regime most appropriate to their governance structure and to commit to a particular regime that can be ascertained by creditors. *See, e.g.*, Franken, *supra* note 222, at 242-46; Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 MICH. J. INT'L L. 1, 32-33 (1997); Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 NW. U. L. REV. 1357, 1403 (2000). Others suggest that the bankruptcy forum should be bundled with corporate law. *See, e.g.*, Armour, *supra* note 9, at 407-08; Eidenmüller, *supra* note 13, at 438-40.

275. Gerard Hertig & Hideki Kanda, *Creditor Protection*, *in* KRAAKMAN ET AL., *supra* note 53, at 71, 74 n.16.

displacing.[276] The U.S. bankruptcy system is the paradigmatic example of a manager-driven system, with executives having powerful incentives to file for chapter 11, which allows them to attempt a turnaround of the corporation while staying in charge.[277] By contrast, European bankruptcy proceedings, including British ones, are manager-displacing, as the corporation is typically liquidated or sold piecemeal by an administrator.[278] Directors are not rewarded with the carrot of prolonged control over the corporation, but threatened with the stick of liability in the case of a late filing. However, it appears that this stick does not work effectively, because the case placers are usually creditors.[279]

2. Conflicts of Interest on the Demand Side

Let us consider what happens when a corporation approaching insolvency could make a case for its COMI in jurisdictions *A* and *B*. Assume both systems are manager-displacing. Managers will fear displacement and usually delay bankruptcy filings as long as possible. If creditors are a homogeneous group, they will submit a petition for bankruptcy in the jurisdiction maximizing the expected value accruing to creditors, which is not necessarily the jurisdiction maximizing total value.[280]

If creditors are heterogeneous, and the law of jurisdiction *A* is favorable to Group 1 (e.g., secured lenders), while jurisdiction *B* is favorable to Group 2 (e.g., unsecured lenders, employees, and so on),[281]

276. *See generally* David A. Skeel, Jr., *An Evolutionary Theory of Corporate Law and Corporate Bankruptcy*, 51 VAND. L. REV. 1325 (1998).

277. *See* John Armour, Brian R. Cheffins & David A. Skeel, Jr., *Corporate Ownership Structure and the Evolution of Bankruptcy Law: Lessons from the United Kingdom*, 55 VAND. L. REV. 1699, 1727 (2002).

278. *See id.* at 1723-30.

279. The reason may be that managers overestimate their chances of accomplishing a turnaround and avoiding bankruptcy or that they fear a hindsight bias on the part of courts, who will find them liable to creditors even if they filed for bankruptcy when they were legally obliged.

280. For example, a Member State might offer a particularly effective reorganization proceeding.

281. *In re* MG Rover Espana S.A., [2006] EWHC (Ch) 3426, [8] (Eng.) ("[I]n striking the balance between the interests of employees on the one hand the interests of finance and trade creditors on the other, English insolvency law treats the claims of employees less favourably than the law of other Member States."). Similarly, in the *Eurofood* case, recently decided by the ECJ, Bank of America tried to place the case in Ireland, apparently to avoid ending up in Parma under an insolvency law that is clearly much more favorable to unsecured creditors than to secured ones (due to the broader scope of the Italian law on preferences and fraudulent transfers, especially at the time of the proceeding's opening). This might have

a race to file between creditors may develop.[282] Its outcome may depend on pure chance, but also on different prerequisites for bankruptcy in different jurisdictions,[283] or even on the procedural rules and safeguards for the debtor's right to a fair hearing.[284] If one jurisdiction allows a petition for (involuntary) bankruptcy earlier than the other, the group of creditors favored by this jurisdiction will prevail.

The prospect of forum shopping by creditors may create an incentive for managers to file for bankruptcy. If jurisdiction *A* favors creditors and jurisdiction *B* favors managers and shareholders, e.g., because rules on directors' liability and veil piercing are lenient, the latter may have an incentive to file in *B* before creditors file in *A*, using their information advantage. Again, the group favored by the jurisdiction allowing the earlier onset of bankruptcy proceedings will win. Note that the costs to managers will be not only monetary, but also include the stigma of having run the corporation into bankruptcy. This may mean that managers will sometimes still delay bankruptcy, even though the bankruptcy proceedings of jurisdiction *B* favor them in purely financial terms. Also, creditors will often prefer bankruptcy

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harmed Bank of America's interests in light of the possibility of consolidating the procedures relating to the various group entities. *See* Case C-341/04, Eurofood IFSC Ltd, 2006 E.C.R. I-3813. *Compare* Royal Decree No. 267 of mar. 16, 1942 art. 67, Gazz. Uff., apr. 6, 1942, No. 81, *with* Bankruptcy Act, 1988 (Act. No. 27/1988) (Ir.), *available at* http://www.irishstatutebook.ie/1988_27.html. In 2005, article 67 was amended to restrict its scope. *See* Decree-Law No. 35 of mar. 14, 2005 art. 2(1)(d), Gazz. Uff., mar. 23, 2005, No. 68.

282. The difference between the two groups may stem from securitization or from a preference for a specific location, as involvement in insolvency proceedings in a distant country may be costly.

283. In some jurisdictions, bankruptcy can only be declared after finding that the corporation is unable to pay debts as they become due. *See, e.g.*, C. COM. art. L621-1 (Fr.); Royal Decree No. 267 of mar. 16, 1942, art. 5, para. 2, Gazz. Uff., apr. 6, 1942, No. 81 (Italy); Faillissementswet [F] [Bankruptcy Law] art. 1 (Neth.); Prawo upadłościowe i naprawcze [Law on Bankruptcy and Rehabilitation] 2003, No. 60, poz. 535 Dziennik Ustaw [Dz. U.] (Pol.); Art. 2 of the Bankruptcy Act (Boletín oficial del Estado [B.O.E.] [Official Gazette] 2003, 164) (Spain); Konkurslag [KonkL] [Bankruptcy Code] 1:2 (Swed.). By contrast, the insolvency laws of other countries include overindebtedness as an additional, alternative criterion for limited liability associations only. In its most basic form, it is fulfilled when total debt exceeds total assets. *See, e.g.*, Konkursordnung [KO] [Bankruptcy Code] No. 337/1914, as amended, § 67 (Austria); InsO, Oct. 5, 1994, BGBl. I at 2866, as amended, Gesetz, Nov. 10, 2006, BGBl. I at 2553, art. 12, § 19; zákon [statute] č. 7/2005 Zbierka zákonov [Zb.] [Collection of Statutes] (Slovk.); Zakon o finančnem poslovanju podjetij [ZFPPod] [Financial Operations of Companies Act] št. 54/1999 Ur.l. RS §§ 12-13 (Slovn.). Needless to say, the interpretation of the criterion varies among jurisdictions.

284. This is also an area where Member States can be creative in anticipating the date of an insolvency proceeding's opening. *See* discussion *supra* note 230.

proceedings in, or close to, the state of their own residence and consider bankruptcy proceedings abroad more costly.[285] However, in many cases, it will be possible to solve this problem by opening secondary insolvency proceedings.[286]

Generally, there are still good reasons to believe that managers/shareholders will usually beat creditors in the race to file. As insiders, they possess a considerable information advantage, allowing them to assess whether the corporation is eligible for bankruptcy and possibly to win the race for filing because creditors do not know yet that illiquidity is impending. Furthermore, managers/shareholders will know better than creditors in which countries a good case for COMI can be made, and what options are available. Rational managers with sophisticated counsel should be able to use forum-shopping opportunities to their advantage. However, whether insiders will prevail in the way described, to some extent depends on who the particular creditors are. If the corporation is tightly supervised by a financial institution, the advantage may be close to nonexistent. There are also reasons to believe that certain groups of creditors will typically win over other groups in a race. In many cases, sophisticated, secured creditors will be better informed both about the financial situation of the debtor and about forum-shopping opportunities. They may even enter coalitions with managers to the detriment of nonadjusting creditors.

Most likely, forum shopping will be to the detriment of tort creditors, who are unable to adjust their claims. A firm might move to reincorporate, with the assent of large lenders protected by an acceleration clause, in a jurisdiction where the position of tort creditors is particularly bad, and establish a COMI there on the basis of the presumption in article 3 of the EIR.

Note that a slight slant in favor of management may not necessarily be detrimental in principle. Besides management, there

285. This was probably the issue in a recent case concerning a conflict of competence between Czech and German courts. Czech creditors submitted a petition for bankruptcy in Prague while the debtor, an unincorporated German entrepreneur, filed for bankruptcy in Hamburg. Městský Soud [MS] [Circuit Court in the City of Prague] Apr. 26, 2005, čj. 78 K 6/05-127, 26 ZIP 1431 (2005); LG Hamburg Aug. 18, 2005, 326 T 34/05, 26 ZIP 1697 (2005).

286. *Cf.* Franken, *supra* note 222, at 255 ("[I]f creditors of an establishment located in another Member State have statutory priority rights that do not have equivalents under the home-country law, they can protect their priority position by filing for a secondary bankruptcy proceeding.").

may be other stakeholders with an interest in keeping the corporation going, such as employees whose human capital is to some degree tied up in the firm and not protected by complete contracting. To be sure, Lynn LoPucki, the leading academic critic of bankruptcy forum shopping in the United States, argues that forum shopping has hurt the bankruptcy system by allowing bad management to stay in office and by letting many prepackaged bankruptcies go through where the insolvent corporation needs to refile within a few years.[287] This may indicate that forum shopping has allowed the U.S. system to tilt too strongly in favor of reorganization.[288]

3. Supply Side

On the supply side of the market for bankruptcy law, Member States could theoretically offer postinsolvency rules catering to the interests of any group. Among the strategies available, it may be most promising to cater to managerial interest, given the managerial head start in information. Because Member States have different substantive bankruptcy laws, a State might even implement manager-driven bankruptcy proceedings in order to attract filings.

It seems interesting to consider what strategies Member States engaging in regulatory competition could take or, to put it differently, what kind of law would attract case placers. The most obvious example is a law providing strong managerial control in bankruptcy, along U.S. lines. If managers and controlling shareholders with them stay in control of the firm during bankruptcy by filing in a particular country, it would give them a considerable *ex post* advantage over creditors. Furthermore, states allowing early filings or petitions for bankruptcy would also be attractive, at least to the group favored by bankruptcy proceedings in that particular state.[289] The favored group, be it managers or a particular segment among creditors, could seize the opportunity to initiate filings. The supply of a bankruptcy law

287. *See* LOPUCKI, *supra* note 6, at 97; LoPucki & Kalin, *supra* note 6, at 270-71.

288. For a more positive assessment of bankruptcy venue choice in the United States, see Cole, *supra* note 5, at 1859-76; Rasmussen & Thomas, *supra* note 5, at 1396-406; Skeel, *Bankruptcy Judges and Bankruptcy Venue*, *supra* note 5, at 27-29; Skeel, *What's So Bad About Delaware?*, *supra* note 5, at 326-28; Ayotte & Skeel, *supra* note 5, at 1517.

289. For example, under section 123 of the U.K. Insolvency Act, default on an undisputed debt over £750 is sufficient to prove insolvency, whereas in Germany, the creditor needs to show that the debtor is unable, and not merely unwilling, to pay. *See* Schall, *supra* note 9, at 1538. The leading English case is *Cornhill Insurance plc v. Improvement Services Ltd*, [1986] W.L.R. 114 (Ch.) (Eng).

favorable to any particular group should thus be made more attractive by allowing that group to file early before an interested group launches a petition in another state.

As in regulatory competition for corporate law, any influence on the development of the law as such hinges on whether its suppliers have an incentive to cater to the interests of decision makers. Only if there is such an incentive will the development of the law itself be influenced, turning mere forum shopping into actual regulatory competition. The biggest problems for regulatory competition are incentives on the supply side, which are often idiosyncratic and hard to predict. According to Lynn LoPucki, judges are motivated by the glamour of handling "celebrity" bankruptcies and their increased standing in the community resulting from it.[290] While this may have been the original incentive for the individual judges who started attracting cases to New York and Delaware, pressure from local bankruptcy bars that wanted to avoid losing business to Delaware, seems to have become an important factor later.[291] Still, even this has not become a universal incentive for other courts to adapt their procedures.[292]

Although there is little doubt that the potential rents to be gained from forum shopping are bigger if not just minor differences in the interpretation of a single bankruptcy code (as in the United States), but a variety of bankruptcy laws are at issue,[293] it is too early to conclude that legislators will enter regulatory competition under the EIR regime. First, the gains to be made are probably limited to a considerable degree by secondary insolvency proceedings. Second, the number of firms where gains are possible is relatively small. To be sure, this may be true also in the United States, where forum shopping for chapter 11 "prepacks" seems to be an option mainly for large borrowers. Similarly, the COMI standard grants forum-shopping opportunities only to firms with considerable international activities and, by means of the presumption of COMI in the state of incorporation, to pseudo-foreign companies. However, COMI allows case placers to choose among a limited selection of venues; while in the United States, "large

290. LOPUCKI, *supra* note 6, at 19-20.
291. *See id.* at 124-28.
292. *See id.* at 21-24 (discussing Boston judges' refusal to enter the competition).
293. *See id.* at 207.

public companies [are] free to file their bankruptcies pretty much anywhere they [choose]."[294]

These two factors combined make it rather unlikely that local bankruptcy lawyers in Europe will have to fear loss of large portions of their business. It is hard to see why Member States should allow themselves to be pressured into changing their bankruptcy laws in ways that give rent-seeking opportunities to managers or other groups. Given that Member States themselves can hardly gain financially from handling bankruptcy proceedings, the crucial issue probably is to what extent particular groups (bankruptcy lawyers in particular) will be able (and have an incentive) to influence legislators, or possibly judges, to change the law or its interpretation to generate revenue for the bar.

4. Conclusion

The EIR offers *ex post* forum-shopping opportunities that European bankruptcy systems will have to address. Although an *ex ante* commitment to a particular bankruptcy system would likely be beneficial, COMI and its ambiguities for multinational groups and companies are here to stay. Consequently, at least some creditors are likely to be hurt by forum shopping. That said, we can reasonably predict that states will not actively compete to attract bankruptcies.

V. THE "RELABELING" OF CORPORATE LAW RULES AS INSOLVENCY LAW RULES: LIMITS AND IMPLICATIONS

Shortly after *Centros* opened the door for regulatory arbitrage in the corporate law field, the Council adopted a regulation which seemingly ruled out forum shopping and regulatory arbitrage in the bankruptcy law field. While we have seen that such objective was far from attained by the EIR, it is also true that whatever State succeeds in opening the insolvency proceedings will be able to apply its own insolvency law rules, even to foreign entities, with due exceptions and qualifications. Hence, States (and legal scholars before them) may be tempted to requalify corporate law rules as insolvency law rules so as to apply their domestic law to foreign entities, as though *Centros* did not exist. With respect to postinsolvency corporate law rules, i.e., those that de facto operate only if a corporation becomes insolvent, the

294. *Id.* at 15.

outcome of such a relabeling would be practically the same as prior to *Centros*.

As a matter of fact, various commentators do consider insolvency law (and tort law) to be a sort of safe haven protecting domestic provisions from review by the ECJ.[295] However, two caveats need to be made. First, *secondary* EC law (like the EIR) can hardly mend a violation of *primary* law by a Member State. Second, it is not evident why the ECJ should take a formalistic perspective and bother to consider in which field of national law a creditor-protection mechanism falls if its effects are identical.[296] In fact, as we have seen in Part IV.A, the ECJ's criteria for the qualification of rules as insolvency law are autonomous from national laws and are strictly related to substantive and procedural features of bankruptcy law.

In light of *Gourdain*, for instance, commentators tend to exclude claims that can be brought irrespective of whether a corporation goes bankrupt, like claims against directors for breach of their ongoing duties, that are among those covered by the *lex fori concursus*.[297] Of course, actions based on English provisions on wrongful trading would certainly be included among those covered by the English *lex fori concursus*, should a proceeding be opened in England.[298] Similarly, claims against directors arising from breach of the duty to file for insolvency are also held to be covered by the *lex fori concursus*.[299]

295. *See, e.g.*, Christian Kersting & Clemens Philipp Schindler, *The ECJ's* Inspire Art *Decision of 30 September 2003 and Its Effects on Practice*, 4 GERMAN L.J. 1277, 1290 (2003) ("*Existenzvernichtungshaftung* . . . or liability for undercapitalization can only be applied to foreign companies if they are understood as institutes of the law of torts or of insolvency law."); Hanno Merkt, *Creditor Protection and Capital Maintenance from a German Perspective*, 15 EUR. BUS. L. REV. 1045, 1057 (2004) ("[A] tort law based solution would, as a general legal principle, be immune to findings that it violates the principle of freedom of establishment."); Ulmer, *supra* note 62, at 1207.

296. *See, e.g.*, Armour, *supra* note 9, at 405-06; Eidenmüller, *supra* note 174, § 3 cmt. 9; Kieninger, *supra* note 93, at 753; Karsten Schmidt, *Publizität von "Schein-Auslandsgesellschaften" durch Firmenrecht und durch Angaben auf Geschäftsbriefen*, *in* EUROPÄISCHE AUSLANDSGESELLSCHAFTEN IN DEUTSCHLAND 15, 25 (Marcus Lutter ed., 2005) [hereinafter Schmidt, *Publizität*]; Karsten Schmidt, *Verlust der Mitte durch "Inspire Art"?—Verwerfungen im Unternehmensrecht durch Schreckreaktionen der Literatur—*, 168 ZHR 493, 499 (2004).

297. *See* Case 133/78, Gourdain v. Nadler, 1979 E.C.R. 733 (discussed *supra* note 235); Virgos & Schmit, *supra* note 217, para. 172, at 301.

298. *See* Schall, *supra* note 9, at 1549.

299. *See* VIRGÓS & GARCIMARTÍN, *supra* note 205, at 82; Horst Eidenmüller, *Insolvenzrecht*, in AUSLÄNDISCHE KAPITALGESELLSCHAFTEN, *supra* note 64, § 9, at 310, cmts. 25-33, at 317-18; *see also* Gerd Leutner & Olaf Langner, *Durchgriffshaftung bei Scheinauslandsgesellschaften*, 2005 ZINSO 575, 577 (suggesting that German *Insolvenzverschleppungshaftung* should apply when an insolvency proceeding is opened in

However, this view is not uniformly held; some authors and recently one lower court have in fact argued that issues of liability for late filing should be decided according to the law of incorporation,[300] although this case was decided differently on appeal.[301]

Hence, the relabeling of corporate law provisions as insolvency law may only work provided that these provisions are properly "insolvencified," i.e., as long as a sufficient number of features linking them to the insolvency proceeding and its objectives are introduced. As a consequence, in most cases insolvencification cannot be the product of scholarly or judicial interpretation. Instead, an intervention by national lawmakers and a profound revision of existing legal doctrines will be needed for relabeling to be successful.

Further, insolvencification may prove to be useless for extending the scope of domestic laws to entities incorporated in other Member States. Whenever insolvency law rules may be held to have a more than indirect and uncertain impact upon the exercise of freedom of establishment, they also must be consistent with the *Gebhard* criteria.[302] Admittedly, insolvency law or tort law rules will typically apply without regard to the particular legal form, meaning that one of the *Gebhard* criteria—application in a nondiscriminatory manner—will be met more or less automatically, which is in stark contrast to pseudo-foreign corporation statutes.[303] But no such automatism will work with regard to the other criteria.

Germany and citing *Gourdain* as an important argument); Rouven Redeker, *Die Fortführung insolvenzreifer Gesellschaften nach "Inspire Art,"* 2005 ZINSO 1035, 1037 (same); Friedrich Rüffler, *Die Behandlung von Scheinauslandsgesellschaften*, 2 GES 411, 416-17 (2005) (same); Philipp Ungan, *Gläubigerschutz nach dem EuGH-Urteil in "Inspire Art"—Möglichkeiteneiner Sonderanknüpfung für die Durchgriffshaftung in der Insolvenz?*, 104 ZEITSCHRIFT FÜR VERGLEICHENDE RECHTSWISSENSCHAFT 355, 368 (2005) (same).

300. *See, e.g.*, Spindler & Berner, *supra* note 193, at 12; Sebastian Mock & Charlotte Schildt, *Insolvenz ausländischer Gesellschaften mit Sitz in Deutschland*, *in* GRENZÜBERSCHREITENDE GESELLSCHAFTEN, *supra* note 98, § 16 cmts. 43-48; *see also* AG Bad Segeberg Mar. 24, 2005, 17 C 289/04, 95 GMBHR 884 (2005) (rejecting a claim for damages on the grounds that English law applies and German law cannot be superimposed in light of ECJ case law).

301. LG Kiel Apr. 20, 2006, 10 S 44/05, 61 BB 1314 (2006) (qualifying the duty to file for insolvency as corporate law and allowing a damages claim against an English Ltd under German law and arguing that this was compatible with EC law).

302. *See* Case C-55/94, Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995 E.C.R. I-4165; Armour, *supra* note 9, at 405.

303. *Gebhard*, 1995 E.C.R. at I-4165; *see* Schanze & Jüttner, *supra* note 62, at 668 (pointing out that general laws of commercial traffic—*allgemeines Verkehrsrecht*—will usually not violate primary law); Schmidt, *Publizität*, *supra* note 296, at 25-26 (pointing out

As previously hinted in Part IV.A, at least in theory fraudulent conveyance could be one of the areas where insolvencification, i.e., the introduction of rules that are functionally equivalent or similar to rules previously found in corporate law, may work out within the EU. Fraudulent-conveyance rules can in fact tackle opportunistic behavior in the form of asset diversion similarly to corporate law's limits on distributions. The problem is that EIR's article 13 opens the door to regulatory arbitrage with regard to these kind of rules. Because, of course, insolvencification could not take place on a discriminatory basis, it would mean opening the door for regulatory arbitrage for domestic as well as foreign companies. If companies started to engage in concealed distributions through contracts for which parties chose the law of a Member State not allowing for any means of challenging them, the relabeling of rules limiting distributions as fraudulent transfer might hinder the effectiveness of rules aimed at preventing asset diversion in jurisdictions where concealed distributions are now covered by corporate law.

Finally, we have seen that at least in some countries, like Germany, the qualification of the equitable-subordination doctrine is disputed.[304] In light of the discussion of ECJ case law on bankruptcy above, which is construed narrowly to refer only to "judgments which are delivered directly on the basis of the insolvency proceedings and are closely connected with such proceedings,"[305] it seems clear that a subordination doctrine such as the German one that becomes applicable before insolvency and can result in a duty of shareholders not to recall the loan even if the corporation does not go bankrupt, does not necessarily fall under the scope of the EIR.[306] The question of

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that provisions regulating commercial conduct are less likely to violate primary EU law than rules erecting entry barriers).

304. *See* Eidenmüller, *supra* note 299, cmts. 42-43 (qualifying the rules as corporate law); Forsthoff & Schulz, *supra* note 98, cmts. 40-47. *But see* Ulrich Huber, *Gesellschafterdarlehen in der Inlandsinsolvenz von Auslandsgesellschaften*, *in* EUROPÄISCHE AUSLANDSGESELLSCHAFTEN IN DEUTSCHLAND, *supra* note 296, at 131-221 (arguing only the statutory rules (*Novellen-Regeln*), but not the independent case law (*BGH-Regeln*), should apply to foreign corporations); Ulmer, *supra* note 62, at 1207 (same); Weller, *supra* note 268, at 414 (same); Zöllner, *supra* note 94, at 6 (same). For Austria, see Sabine Dommes et al., *Die englische* Private Company Limited *in Österreich—Gesellschaftsrechtliche Fragen*, 15 STEUER UND WIRTSCHAFT INTERNATIONAL 477, 484 (2005).

305. EIR, *supra* note 10, pmbl., para. 6.

306. However, the German Ministry of Justice has recently proposed an amendment to German corporate and insolvency law that would make subordination an insolvency concept. This would (if implemented) apply to all business associations that do not have a personally

whether a Member State can apply such a provision to foreign corporations would have to be decided under the *Gebhard* criteria. In any case, it seems safe to say that certain rules could be recast to fall under the reach of the EIR directly by establishing a reasonable connection to insolvency proceedings, while the main thrust of the rule remains the same.

But where effective relabeling is feasible, is it truly desirable from the perspective of a Member State intending to implement its own policies for creditor protection? The above discussion of forum shopping in European bankruptcy law casts serious doubts on this proposition. The better relabeling works and the larger the field covered by bankruptcy law, the smaller the opportunistic gains that can be made by regulatory arbitrage in corporate law. However, on the flipside of the coin, the reduced significance of corporate law shopping increases the incentive to engage in *ex post* forum shopping in bankruptcy because shareholders and managers placing the case will have more to gain later on. In some situations, this may even be worse from the creditors' point of view. Opportunistic bankruptcy forum shopping under the EIR may be more difficult to predict than corporate law shopping and cannot be prevented by contract.[307] If such can be the outcome of relabeling, then one may question whether it is at all wise for policymakers to engage in it. It may even be detrimental to the position of creditors and thus raise the capital costs of firms. At the very least, advantages and disadvantages of *ex post* choice-of-law decisions in the two fields will need to be weighed against each other with respect to particular issues.

VI. CONCLUSION

Following *Centros*, all Member States now must essentially defer to private parties' choices with regard to corporate law.[308] This has

liable member who is a natural person. *See* MOMIG, *supra* note 94, at 20-21 (proposing INSO § 39(4)).

307. Creditors may sometimes be able to contractually reserve the right to replace the board of directors if certain specified events occur and then eventually take full control of the corporation, or they may practically have that power without a legally enforceable stipulation to this effect, which will prevent forum shopping *ex ante*. *See* Douglas G. Baird & Robert K. Rasmussen, Essay, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1213-23 (2006). Needless to say, most creditors will be quite reluctant first to reserve and then to exercise this form of protection. Furthermore, where such a protection is exercised, this will benefit large financial creditors, whose interests may not coincide with other creditor groups.

308. *See supra* notes 56-64 and accompanying text.

already prompted regulatory arbitrage at the incorporation stage and, following positive harmonization efforts by the EC, may soon make it possible for existing companies as well. At the same time, the EIR has deeply affected regulatory interactions in the realm of insolvency law by increasing the opportunities for forum shopping. These two developments together have significantly reshaped the regulatory environment for the relationships between corporate debtors and their creditors.

This Article has provided a picture of such a post-*Centros*, post-EIR environment. We have shown that despite the positive harmonization efforts by the EC, creditor-protection regimes still differ across the EU, so that the regulatory surplus to be gained from (re)incorporations is still large enough. Regulatory arbitrage at the incorporation stage in order to escape minimum capital rules cannot yet be taken as evidence for a race to the bottom because such rules are outdated and provide no meaningful protection for creditors. We cannot rule out the possibility that companies engage in midstream reincorporations in order to exploit unsophisticated and nonadjusting creditors. However, in the absence of a European Delaware, the odds are against a U.S.-style, intense regulatory competition in this area of law.

While the incorporation doctrine has been imposed upon Member States with respect to corporate law, the EIR has de facto harmonized conflict-of-law rules in the insolvency domain by picking something close to the real-seat doctrine, i.e., the fuzzy COMI standard. When a corporation incorporated abroad to take advantage of more attractive corporate law rules goes bankrupt, the COMI's insolvency law will have to apply together with the incorporation State's corporate law. The EIR, with its emphasis on pure temporal priority for the opening of the main proceedings, provides incentives for a race to file between the corporate debtor and its creditors. This, in turn, might prompt some Member States to reform their insolvency laws so as to make them more favorable to managers and shareholders in order to attract insolvency business. In light of the relevant interest groups in action, we doubt that any Member State will have sufficient incentives to engage in broad-scope regulatory competition.

Still, the policy goal of protecting creditors prevalent in many Member States may tempt legislators to relabel corporate law rules so as to make them applicable to pseudo-foreign entities. However, relabeling requires insolvencification of the relevant doctrines, meaning that they will have to apply only within the insolvency context and in close connection with the proceeding. Member States will then have to decide whether the benefits of having those doctrines (possibly duly tamed in order to pass the *Gebhard* test) applied to bankrupt foreign entities outweigh the costs (if any) of not being able to apply them to nonbankrupt domestic entities. Finally, as long as the EIR does allow forum shopping and hence insolvency law arbitrage, relabeling may increase the regulatory surplus a corporation can derive from forum shopping through an opportunistic switch of COMI. This may even increase the exposure of creditors to opportunistic conduct by shareholders and managers and thus increase the cost of debt for all companies with international operations. It is therefore doubtful whether relabeling is actually desirable from the Member States' perspective.